



**POSITION PAPER ON
CESR's PUBLIC CONSULTATION
CONCERNING
BEST EXECUTION UNDER MIFID**

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ALFI welcomes CESR's analysis on "Best execution under MiFID" published in its public consultation of February 2007. Having a common approach between regulators on this topic will be most helpful for market participants.

We are supportive of the positions taken by CESR in this consultation, but recognise that there is still a need, not addressed in this paper, for guidance on best execution in the context of quote-driven markets (where we understand CESR is in communication with the EU Commission).

Further the consultation paper does not address best execution as it applies to investment funds. Such guidance would be helpful in the light of what appear to be diverging approaches being taken by EU regulators in applying the rule in their own markets. To assist in the deliberation of an EU coordinated approach, we would like to make several remarks as to the application of the best execution rules to funds and would propose following this up in more detail should CESR feel this is useful.

ALFI is the representative body of the 1.8 trillion Euro Luxembourg fund industry. It counts among its members not only investment funds but a large variety of service providers of the financial sector. As such ALFI also represents next to the fund industry's direct participants key players in the distribution of fund products.

I. GENERAL COMMENT

Article 21 of the Directive defines "best execution" as the obligation for investment firms "to take all reasonable steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order." It should be noted that although MiFID does not apply to fund promoters, its best execution requirements apply to mutual funds as financial instruments distributed by investment firms. Distributors placing orders for mutual funds will be undertaking the MiFID activity of receipt and transmission of orders and as such subject to the requirements of Article 45 of the implementing Directive.

If a mutual fund is listed on a regulated market, the distributor would thus need to assess whether a best execution obligation would require it to deal via a stock exchange – in the case of the existence of a secondary market for investment funds– or through the fund's own distribution network or indeed via a funds platform run by someone other than the promoter. Whilst MiFID rightly aims at increasing competition between various distribution channels, it must be underlined that the proof of best execution will be difficult to achieve in practice. The trading of fund units (based on net asset value in accordance with the UCITS Directive) is not comparable to that of securities which are sold solely via exchanges.

As from our point of view the issuance and redemption of fund units is not subject to best execution as it does not amount to an execution of client orders..

This consideration derives from article 44 para 1 MiFID Implementing Directive which determines that order execution needs to be conducted at execution venues which comprise inter alia MTFs, systematic internalisers, market makers or other “liquidity providers”. As to the fact that the depositary of a fund is neither an MTF nor a systematic internaliser or a market maker and his duty is to issue and redeem fund units and not to be responsible for the provision of liquidity, the function of the depositary is not comparable to “liquidity providers”. In consequence, it cannot be considered as an execution venue in the sense of article 44 of the said Directive.

In addition, it has to be taken into account that the pricing of investment funds units is based on the net asset value of the fund according to specific rules of the UCITs law and therefore cannot be compared with market prices available at stock exchanges which have not such a basis.

II. SPECIFIC COMMENTS

First of all, we would like once again to point out that as of our understanding article 44 of the MiFID Implementing Directive does not cover the issuance and redemption of investment funds via the depositary as explained above. As a consequence no further consideration on best execution rules should be necessary. Nevertheless, we would like to illustrate further aspects against the application of best execution in case CESR does not share this understanding.

Best execution rules imply that, where there are alternative channels to purchase a particular mutual fund (such as being listed on a regulated market) an investment firm in receipt of an order to deal in a particular fund will need to:

- implement an order execution policy
- obtain the best possible result for the execution of client orders on a consistent basis
- ensure transparency of the execution characteristics vis-à-vis their clients.

Articles 44 and 45 of the Implementing Directive specify that best execution of a retail client order should be determined on the basis of:

- the price of the financial instrument
- all costs related to the execution of the order: all expenses incurred by the client which are directly associated with the execution, execution venue fees, clearing

and settlement fees and any other fees paid to third parties involved in the execution of the order.

The European Fund and Asset Management Association highlighted already in March 2006 that “price/cost should be the most important factor for determining the best possible result for retail clients” but that “other factors may in balance be more relevant, such as quality and security of execution, speed, market coverage, integrity of the broker, the capacity and expertise to deal in niche markets.”

Some market players have gone so far as to advocate that “trading funds on the stock exchange provides best execution under MiFID”, arguing that a high transparency would be guaranteed thanks to real-time trading at the Stock Exchange and to the cost saving that can be achieved by investors trading via a stock exchange. However, this is to ignore the effect of spreads taken by such brokers (which are not disclosed in the same way loads are). In addition, if best execution would be applicable to the ordering of funds via the management company, the load cannot be considered as part of the price. Instead, the load is part of the remuneration for the investment advice service of the intermediary.

While regulated secondary markets for fund trading do not exist in all EU Member States for funds, the question is already being asked whether best execution is better achieved by means of a price determined by supply and demand (secondary market) or a price calculated at the net asset value.

We have a serious reservation as to whether it is realistic to compare a secondary market price to the NAV of a fund, considering that the prices are not comparable. If someone argues that the NAV will only be known after the execution of the client order, this argument cannot be followed as to the fact that in case of ordering on a secondary market there is no certainty that the price will be reached. Moreover, such an assessment will be burdensome and could entail that the sales of funds become less attractive than the sales of other products which are only sold through a single channel. We therefore support the view of some national legislators who consider that transactions in mutual funds would not be subject to best execution requirements.

III. Conclusion

The Directive and Implementing Directive have defined principles in terms of “best execution”. Fund promoters do not fall under the scope of MiFID, but mutual funds do as they are financial instruments traded by investment firms falling under MiFID. European supervisory authorities should take into account the practical impact of MiFID requirements on the fund distribution in Europe.

The existing distribution model is well established and any regulation that is detrimental to this model yet does not deliver investor or structural benefit should be avoided. ALFI remains at CESR’s disposal to discuss the abovementioned issues more in-depth.

