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To: CESR  
Committee of  
European Securities Regulators  
11-13 Avenue de Friedland  
75008 Paris

**RE : CESR's Advice on Possible Implementing Measures of the Directive  
2004/39/CE on Markets in Financial Instruments – Best execution**

## **Introduction**

ASSOSIM is the Italian Association of Financial Intermediaries, which represents the majority of Italian financial intermediaries, banks and branches of foreign institutions, active in the Investment Services Industry.

We very much appreciate that CESR postponed the deadline for responses on the first set of Possible Implementing Measures of the MIFID as far as best execution and market transparency issues are concerned.

This decision gave us the opportunity to go deeper into the matter of best execution which from the intermediaries' perspective is a very delicate one. In particular, we would like to highlight that for intermediaries of countries where the rule of concentration of orders applies under the directive 93/22/CE the best execution policy is a new concept which implies a cultural change of approach earlier than a change of business model and a set of new procedures. Therefore, on this matter the issue of time, already dealt with in the introduction to our response of 17<sup>th</sup> September, is particularly important. This issue should be considered not only in the sense of the two years given for the adoption of implementing measures and transposition, but also in the sense of the period necessary to intermediaries to implement new procedures once the legislation is in force in member states.

However, we agree on the choice of the legislator expressed in article 21 of the MIFID, who first of all acknowledges that the best result of the execution is necessarily a wide concept that contains different factors - among which the price.

Moreover, the legislator clearly shows to acknowledge that in a situation of internalisation of orders and fragmentation of the executions, the principle of best execution loses its absoluteness and becomes relative to the venues the intermediary can search before executing the order, compatibly with its means.

The ratio of this article is to be found in the two mentioned elements deeply linked which are respectively contained in the par. 1 and 2 of article 21. Under this article at par. 2 the investment

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firms are required to establish and implement an order execution policy (agreed upon with the client) to allow them to obtain for their clients' orders the best possible result (in accordance with art. 21 par. 1). **Given the above there is no room for an interpretation which foresees an assessment of the best execution on a trade by trade basis. The intermediary will guarantee the best result to its clients by following the procedures provided for by the best execution policy.**

Firstly, we wish to address the very concept of best execution as defined in paragraph 1 of article 21, as the best possible result considering price, costs, speed, likelihood of execution and settlement, amount, nature.

Please note that the CESR paper focuses on evaluation criteria of the above-mentioned anticipated factors, whereas no indication is provided **as to other factors** to be evaluated not expressly stated in art. 21 paragraph 1 and which, pursuant to the closing sentence of the said paragraph "and any other consideration relevant to execution of order", could be added by the single intermediaries.

Speaking from the specific point of view of retail clients, the list of article 21 should not be considered exhaustive.

It is felt that this approach could lead to the evaluations of intermediaries being simplistically focused on the criteria set forth in the directive, with respect to non professional investors too, which may result in them overlooking or not being stimulated to weigh up other factors too which may still be as relevant.

It is therefore felt that the CESR should carefully consider this aspect so that it is made clear that other factors too, such as components of best execution, may contribute to the process of setting out a best execution policy of intermediaries and, as direct result of that, may prove an incentive to trading venues for steering their investments with a view to improving their competitiveness. It is our opinion therefore that this would bring benefits in terms of both protection of the investor and make competition between venues more effective.

At this stage of our work, we have identified a further element which can be said to come under the definition of best execution for retail clients: **the management of anomalies** (that would be reflected in the characteristics of venues such as the setting up of monitoring measures) for an effective error management (setting up error management procedures enabling post trade elimination of any damaging effects resulting from blatantly erroneous transactions in due time and with no adverse consequences for investors).

**Criteria for determining the relative importance of the different factors to be taken into account for best execution (art. 21.1).**

We agree with CESR that the determination of the relative importance of the different factors to be taken into account for best execution is a job to be performed by the intermediary.

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In our view such an assessment will strongly depend on the type of business the firm carries out. A self-evident example is the intermediary who only works with retail clients, but we can also mention the intermediary working in the fixed income or shares.

Thinking of those very specialised intermediaries we fear that obliging them to assess all the three factors listed by CESR could be a difficult provision to comply with and not useful in the light of the best execution principle.

Obviously the above considerations do not relate to the criteria regarding the client and order characteristics which should always be assessed by the intermediary since they are specifically mentioned by article 21 par. 6 a) and in particular the investor protection is one of the major purposes of the new legislation.

We acknowledge that the three criteria are deeply linked and that it is possible indeed that most of the times the intermediary will evaluate all of them. Nevertheless it is important to know that in case the intermediary cannot assess the criterion concerning the venues – owing to practical reasons and needs - it is not obliged to do that.

**Therefore the intermediary when determining the relative importance of best execution factors should be left free to consider the criteria suggested by CESR as examples, apart from the criterion concerning the client and order characteristics.**

Another remark concerning the mentioned criteria (client, order and venue characteristics) relates to the explanation of their meaning given by CESR. Just as an example, as for the client characteristics criterion, CESR document reads “we expect that this category will include...” giving a very detailed explanation. Its description contains among the others the trading objectives of the client and demands for ease, speed, low costs, trading advice or confidentiality.

As for the trading objectives we believe that they are something which relates to the single client/intermediary relationship, a wider concept in comparison to the execution which is only an aspect of a more general issue.

As for the second part of the explanation quoted (demands for ease, speed, low costs, trading advice...) we reckon that apart from the main elements which immediately make the difference between retail and professional clients, the others listed by CESR should be considered as factors of specialisation of the single intermediary, in terms of better quality of the services which the competition is based upon.

**Especially in case CESR would decide not to accept our suggestion to consider the three criteria as examples for the intermediaries when making their choices, we would emphasise more the importance of not breaking down into detail when dealing with the content of the criteria.**

**Trading venues to be included in the order execution policy (art. 21.2).**

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The same considerations are valid in regard to the factors affecting the choice of the execution venues to be included in the execution policy.

**The factors given by CESR should be regarded as examples by the intermediaries when choosing the venues to include in the best execution policy.**

Besides the reasons explained above there is a specific one to this issue that if carefully considered would lead to ruling out the opportunity to impose very strict provisions on the way to set the execution policy. We are presently writing a piece of legislation deeply linked to considerations relating to the characteristics of the venues well earlier than witnessing the effects of the internalisation on the market place.

Another issue worth considering when speaking of venues to be included in the execution policy relates to their minimum number. It is not clear whether or not there is a minimum number of venues that “enable the investment firm to obtain on a consistent basis the best possible result” to be included the execution policy, **but in our view it should not be compulsory to search more than one venue.**

Again this choice should be a matter of competition since the Regulators cannot impose the costs of mandatory expensive search and access requirements on firms.

Obviously the choice of the single venue and the way it allows the intermediary to guarantee the best execution shall be adequately motivated in its execution policy.

## **Liability**

A very important aspect of the best execution issue which is worth considering relates to the civil and administrative liability of the intermediary arising from the arrangement of the execution policy.

What clearly arises from the article 21 is a civil liability of the intermediary in case it does not respect the content of the set execution policy agreed upon with the client.

**Some clarifications should be given, instead, on the possible administrative responsibility of the intermediary in setting the execution policy descending from the general principles of honesty, fairness and professionalism in accordance with art. 19 par. 1.**

In other words could the intermediary be liable for the way it decides to combine the factors in order to define the best result and to set its execution policy?

**Moreover, it is important that CESR explain the criteria on which this possible breach of the general principle contained in article 19.1 would be assessed.**

On what basis is the authority going to make exceptions on the intermediary’s assessment of the factors provided for by the regulation (to identify the best results or set the execution policy)?

The issue of liability is of self-evident importance for its implications in terms of sanctions and also in terms of civil responsibility before the client.

**Moreover, if the regulation is not clear on this issue it would imply non-convergence of the supervision which, as CESR knows, is a very important aspect of the activity to be carried out at the 3<sup>rd</sup> level legislation in the light of the real harmonisation.**

In this respect we would suggest that the second level legislation on this issue be adopted by regulation and not directive.

## **Obligation of best execution for the intermediary in charge of reception and transmission of orders and portfolio management.**

A further aspect that should be dwelt on is the compliance with the obligation of best execution in the case of a multiple number of intermediaries working on the transaction, or, on a different subject, in case of investment services other than trading (with specific reference to individual portfolio management and reception and transmission of orders).

The difference between the services mentioned, which is indeed recognized by the same CESR, **should lead to a different graduation and interpretation of the concept of best execution, to be based on the service rendered.** For example, let's take the case of an intermediary portfolio manager (or one just providing the services of reception and transmission of orders) who will be required to guarantee best execution to his client, adopting procedures, even complex ones and totally identical to those executed by brokers acceding directly execution venues. Furthermore, the broker will often adopt a policy of execution tailored to types of clients that are different to that of the intermediary portfolio manager/collector of orders. Therefore the procedure of the latter intermediaries will reflect that different approach, justified by the presence of a plurality of intermediaries in the same transaction.

Another aspect that should not be neglected pertains to the costs of implementation of a complex policy such as that provided for in the new directive in the case of small or medium sized intermediaries providing investment services other than trading.

It is therefore deemed essential that the application of the rules here considered be appropriate and at that the pertinent legislation specifically provide for different investment services. If the rule is not appropriately graduated according to the service rendered, the risk being run is that of generating sizeable additional costs for the structures collecting orders/managing structures.

## **Remarks on other classes of financial instruments**

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The proposed regulation seems to be focused on regulated equity markets. We believe it to be important to represent peculiarities and characteristics of other markets that presently are not considered in an appropriate manner.

**We wish to highlight issues that make it difficult to define Best Execution for orders on classes of instruments, different from equities, that are traded:**

- exclusively OTC
- in regulated markets where liquidity is inadequate for prices to be representative, or where trading is just not possible

For classes of financial instruments traded either exclusively over the counter (OTC) or traded on regulated markets with insufficient liquidity, and therefore necessarily traded “off the regulated market” or OTC, **like for example bonds and derivatives, a relevant “reference price” will just not be available.**

In the OTC market a single “reference price” is not available because every market maker has their bid and offer price depending on: position, willingness to trade, market view etc..

In theory there could be as many prices as there are market makers.

This applies specially to OTC derivatives (e.g. swaps, options, swap options, credit derivatives) and eurobonds and/or international bonds traded OTC.

For these classes of financial instruments it is not possible to apply such concepts as “best result” or to simply declare those “trading venues that enable the investment firm to obtain on a consistent basis the best possible result”. (How many market makers does one investment firm have access to? 40? 50?)

There is even uncertainty as to whether one can talk about “order execution policy” since the client will necessarily have to “request for a quotation” (RFQ).

Upon the client’s RFQ the investment firm will quote a price. The client will then decide whether to trade on that price.

Can this be considered as the “execution of a client’s order”? Probably not, therefore we would like to propose some suggestions on this issue.

Market participants feel that obtaining best execution for a client should be seen as a process.

Therefore it would make more sense for the investment firm to define and then disclose a “best practice” policy when dealing OTC.

This “best practice” would have to be disclosed as the firm’s “execution policy” for those classes of instruments that are traded exclusively or mainly OTC.

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This “best practice” policy would define rules to be applied when pricing OTC traded instruments to achieve “terms most favourable to the client”.

As an example, when defining “best practice” for pricing OTC bonds the investment firm would have to work at “market prices”.

Market prices would be determined by comparing prices available from market makers when available on a MTF, or prices quoted on the OTC market by market makers.

When the investment firm is a market maker, it would quote its own price in line with the market by evaluating the characteristics of the bond (maturity, coupon, senior or subordinated) and of the issuer (credit standing, rating).

We hope to have given a useful contribution and we stay at your disposal for any further clarifications.

Il Segretario Generale  
Franco Gherra



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