Comments by the Spanish Banking Association (AEB) to CESR 07-050b (Consultation Paper) on Best Execution under MiFID

AEB members welcome CESR´s Consultation Paper on *best execution* under MiFID and its pragmatical approach to said principle. In general terms, our members adhere to the distinguished response to the Paper presented by the European Banking Federation, but wish to underline some further issues.

1. General remarks

From the perspective of AEB members, it is of utmost importance that *best execution* requirements are further clarified in order to achieve legal certainty for investment firms. In this sense, Members especially agree with CESR that ***best execution* should be policy driven**, i.e. the obligation to act in the best interest of the client should derive from a general, summary-like in-house policy which describes in a general way the execution approach the investment firm has opted for.

Accordingly, the requirements established by MiFID could be **resumed into 5 major obligations**. An investment firm fulfills its *best execution* duties by (i) having an adequate execution policy which enables it to achieve the best result for their clients on a consistent basis, (ii) informing its clients about said policy (and in case of firms which execute orders, obtaining their clients` consent to said policy), (iii) having regard to their execution policy when executing/transmitting an order, (iv) storing sufficient information to proof that the policy is being observed, and (v) monitoring and reviewing said policy. This notwithstanding, item (v) should not be understood as an obligation imposed on the investment firms to review from time to time the venues selected by it in comparison with all venues available in the market in order to determine which are the best one/s in order to include them in its best-execution policy: the firms are free to select those venues they may consider appropriate and their obligations are limited to provide best execution as per its policy in the venues included therein, and to make it publicly available to their clients. Purporting to impose an obligation to analyze, compare and decide from all venues available is not the purpose of the Directive, the purpose of the Directive is to permit the clients to make an informed decision on which firm they select to execute their orders in the markets.

Accordingly, the CESR paper should state clearly that the best execution system envisaged under MiFID **is aimed at achieving consistency in a firm`s *best execution* approach rather than establishing obligations to evaluate single venues or operations separately**.

In the following, we would like to outline several key issues where CESR`s comments need further clarification in order to avoid legal uncertainty and divergences between member states which would eventually hamper the creation of a *level playing field.*

2. Content, Degree of detailedness, Frequency of modifications

As under the current legal framework it is impossible for investment firms to determine the exact scope of obligations imposed on them with regard to *best execution*, AEB members strongly think that the CESR paper should especially clarify the compulsory **content of the execution policy**, the **degree of detailedness** the policy must have, and the **frequency of reviews** of the established policies due to possible changes in the circumstances under which the investment firm carries out its business (this not being understood as an obligation to analyze, compare and decide from all venues available from time to time, but as a review of the best execution policy assumed by the firm just in case, for instance, from the venues available in its best execution policy, one of them has ceased to be the best execution venue in favor of one of the other two available).

AEB members agree with CESR that **the only objective of the establishment of a *best execution* policy is to enable the client to make a properly informed decision whether he utilizes the execution-related services of the investment firm**. Members therefore understand that the content of the policy, the degree of detailedness necessary, and the review duties must be limited as the client’s right is restricted to information about the general execution approach of a firm. A client can easily complement that information by posing further questions to the entity.

Content of the best execution policy

Some of the information requirements established by CESR in item 22, in particular, items a) and d), go beyond the information requirements of Article 46.2 Implementing Directive. AEB members therefore strongly think that this information does not have to appear in their execution policy.

Members further consider that such information is not of considerable use for clients, at least, as far as technical aspects are concerned. It is, however, expensive for investment firms to generate such information. Costs which are, in this sense, unnecessary should definitely be avoided.

Furthermore, AEB members do disagree with CESR that an execution policy must explain how the different *best execution* factors are related among each other. The legislators approach is **policy driven**, and within such approach it is impossible to fit in an element of weighting different execution factors. The weight of each of those factors will necessarily have to be determined on a case-by-case basis, the legislator, however, favors a general and policy driven approach, improved by and combined with the duty to **only periodically revise the policy**. It is therefore impossible for investment firms to comply with this obligation under a policy driven approach.

Level of differentiation of the policy

One of the fundamental reasons why the legislator has opted for a policy driven approach is the fact that the efforts needed by investment firms in order to comply with their *best execution* duties should be **reasonable**. The reasonability criterion should also be reflected in the degree of differentiation required within the *best execution* policy. AEB members therefore agree with CESR that the policies do not have to distinguish between different types of clients or different types of orders. Investment firms are free to include such differentiation.

AEB members also agree with CESR that a certain degree of differentiation between each class of instruments is necessary. Nevertheless, as the policy merely aims at allowing the client a properly informed decision, the degree of necessary detailedness should be decided by each firm and limited to the major groups of instruments such as equities, debt, and derivatives in organized markets.

Frequency of reviews of the policy due to changes in the execution circumstances

Obviously, an existing execution policy can not be modified due to every single change in the circumstances surrounding the execution, e.g.a change in the sytems of any execution venue being part of its best execution policy. The legislator has rather opted for a **reasonable approach** trying to guarantee best execution by consistent policies which must be reviewed **periodically** in order (i) to check if, from the venues which form part of a firm's policy (but not from those that *might* form part), a change should be included (i.e. when the firm decides that one venue is no more the best one in a certain kind of security in favor of other of the current venues included in its policy) and (ii) to freely allowed the firm to decide whether to include any new venue or exclude any of the current ones from its future policy. The 1-year criterion for reviews would become obsolete if modifications due to any change in the circumstances made a review necessary.

The CESR paper should therefore include **clear, adequate and (economically) reasonable criteria** regarding the frequency under which modifications must be carried out, and avoid the appearance that any change in the execution environment could cause an obligation to review existing policies. Thereby, legal certainty must be created.

CESR itself in items 3 and 17 of the Consultation Paper makes express reference to the necessity of reasonable solutions. Article 21.3 MiFID, for example, expressly refers to venues where the best possible result can be achieved ***on a consistent basis***. Art. 45.6 of the Implementing Directive expresly states that the review should be focused *"on the execution quality of the entities identified in that policy"* and not on making a global due diliegence of all venues available in the markets.

3. Clarification of the differences between the policies under Article 21 MiFID and Article 45 Implementing Directive

The Consultation Paper distinguishes between the contents of the execution policy of firms executing client orders (Article 21 MiFID) and the corresponding policy of RTOs and portfolio management companies (Article 45.2 Implementing Directive).

AEB members agree with CESR, that although the corresponding articles regulating the policies might be worded differently, [*they are both intended] to ensure that the firm has a comprehensive approach to meeting the requirement to take all the reasonable steps to obtain the best possible result for the execution of its clients orders.* In this sense, AEB members support CESR`s view that **relevant parts of the policies may be congruent**.

Nevertheless, the criteria according to which CESR determines the joint content of the policies are unclear. Although AEB members welcome the idea to make apparent joint parts of the policies, it has to be borne in mind that each element of uncertainty entails important risks for investment firms. In order not to double the efforts imposed on them, CESR should therefore **introduce clear-cut criteria and thereby create legal certainty**.

Financial Groups

The CESR paper does not make sufficient reference to the situation under which major financial groups act. CESR should, for example, clarify the requirements set up by MiFID with regard to major banks which collaborate with a broker within the same financial group. In this respect, important synergetic effects with regard to the design of the execution policies should be achievable and the *best execution* criteria may also vary under this special situation. CESR should therefore include corresponding remarks in its Consultation Paper.

RTOs and Portfolio Managers

In the opinion of AEB Members, the content of the policy of RTOs and Portfolio Managers should only imply the disclosure of the intermediaries they place orders with. As the execution of orders is not their core activity, the obligation to inform about the execution venues each of their intermediaries uses, as well as the description how said execution takes place, would be an excessive burden and cause unnecessary costs for these firms.

Although a literal interpretation of the corresponding provisions does not produce clear results and may therefore point to the existence of differences between the policies under Article 21 MiFID and Article 45 Implementing Directive, it has to be borne in mind that **any broker due to its character as an investment firm will also be obliged to comply with the best execution provisions** under MiFID. Accordingly, the obligations imposed on RTOs and portfolio mangers collaborating with such broker **may be considerably reduced**. For example, an RTO should not be obliged to explain within its best execution policy with which investment firms it wants to cooperate (broker selection, etc.) The CESR paper should expressly mention this point.

4. Single Execution Venue

AEB members welcome CESR`s opinion that an investment firm may choose to use a single execution venue only.

Each investment firm is free to select the venues to be included in its policy, and thereinafter, is obliged to take all reasonable steps to obtain the best possible result for its clients from such venues. In this respect, it has to be pointed out that all relevant aspects, such as access costs, reliability of a new venue, etc. have to be borne in mind under the perspective of reasonability. In line with our references made to the only periodic review of the execution policies, it is essential to note that the **emergence of new venues does not imply an obligation on the firm to review its policy *per se***.

AEB members understand that the consideration of new venues should be taken apart from the obligation to periodically review the existing *best execution* policy. In this sense, the CESR paper should state expressly **that there are no obligations for investment firms to undertake reviews with regard to new execution venues, but to generally review their execution policies as they have selected them**.

Article 46.1 Implementing Directive imposes the obligation to review the execution policy at least annually and each time a material change occurs. In this sense, the appearance of a new venue should not be considered one of such changes (unless it is included in the policy), and should not by itself lead to a review of the execution policy.

Quality of execution venues

We welcome CESR`s view that fees and commissions charged by the investment firm to its clients should not be taken into account when selecting the execution venues to be included in the firm`s *best execution* policy. The selection should exclusively focus on the quality available on the venue in question. By distinguishing clearly between the selection of execution venues and cost factors, legal certainty should be provided.

5. Total Consideration

AEB members agree with CESR that implicit costs should not be taken into consideration as far as retail clients are concerned as such costs are unlikely to be a consideration for most retail clients. Members strongly think that the costs to be taken into consideration can only be costs a client bears in mind at the time of the transaction, especially the costs for which he actually will have to make payments himself.

With regard to professional clients, as CESR correctly states, investment firms are merely obliged to weight the factors in a manner that is **appropriate** to the particular type of client. Accordingly, CESR should expressly draw the conclusion that the *total consideration* concept, while very helpful indeed in the case of retail clients, may become all but irrelevant with regard to some professional clients.

Financial Groups

AEB members welcome the possibility established by CESR for RTOs and portfolio managers to direct all orders to an affiliated firm within their own corporate group. CESR foresees this possibility if by this way a more advantageous result for clients can be achieved on a consistent basis.

6. Disclosure: Information about the execution policy

In general terms, AEB members agree with the disclosure requirements set out in the CESR paper as they directly reflect the content of Article 46.2 and Article 45.5 Implementing Directive. Accordingly, AEB members agree with CESR that it is up to the investment firms to decide which level of disclosure is appropriate for professional clients.

Nevertheless, as the information to be provided has to be “appropriate” the CESR paper lacks the information that situations may arise under which the extent of information to be provided may be reduced due to the circumstances of the concrete situation, as foreseen by Recital 44 Implementing Directive. Investors prefer simple, concise and relevant information.

Waiver of information rights

The CESR paper should expressly state the clients` right to waive the protection created by disclosure duties.

Information on websites

As CESR correctly states, Article 3.2 Implementing Directive **admits the web page as a means for providing retail clients with adequate information about a firm’s execution policy**. Due to the fact that under the MiFID system the protection of professional clients is minor to the protection of retail customers, the disclosure obligations with regard to professional clients can also be fulfilled by publishing the relevant information on the investment firm’s *website.*

Electronic means which are more personalized than a website (such as e-mail, etc.) should also expressly be admitted as viable means for client information.

7. Clients` Consent

As CESR correctly states, the objective of the obligation to receive a clients` consent to the execution policy is that the client should be able to compare different execution services offered by different investment firms. The CESR paper, however, lacks the logical conclusion from that position, i.e. that **tacit consent of the client is necessarily sufficient** to achieve that aim.

Investment firms may nevertheless prefer to ask for the clients` express consent and are free to do so bearing in mind further provisions of their domestic legislation. The CESR paper should make express reference to that fact.

AEB welcomes CESR´s view expressed in item 62 of the Consultation Paper that express consent may be provided by a simple click on a web page.

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