

COMMENTS BY THE CNMV ADVISORY COMMITTEE ON THE CESR DOCUMENT REGARDING BEST EXECUTION

DOCUMENT ON BEST EXECUTION IN MIFID

The document deals with the following issues:

Execution policy and arrangements
Disclosure
Consent
Chains of execution
Review and monitoring
Execution quality data
Other issues

EXECUTION POLICY AND ARRANGEMENTS

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.**

The order execution policy's content must at least match that required by MiFID, i.e.: (i) information about the various venues where the company executes client orders, and (ii) the factors influencing the choice of execution venue in each case.

This Committee considers it reasonable that the best execution policy should state how the entity addresses best execution for different types of client, security and trade, with a general explanation of the relative importance of the various factors in each case, and that it should reflect the conclusions set out in paragraphs 41 to 46 of the CESR document ("Differentiation of the Policy"), with specific emphasis on differentiating between the factors of importance for retail and wholesale clients, as set out in paragraphs 23 to 30 of the CESR document.

It also considers it appropriate that the content of the best execution policy be reviewed and amended as the Directive requires (i.e. at least once per year, and whenever there is a material change of circumstances). Since clients must be informed of the content of the best execution policy, the system for reviewing and amending it is an important factor of which clients should be aware, and this should enhance client trust in the entity

as they will be aware that the entity makes efforts to keep its best execution policy up to date.

Nevertheless, this Committee believes that a disclosure of the factors affecting the choice of venue by the entity should not be part of the minimum content of the best execution policy. A generic reference to these factors should suffice. However, a detailed analysis of the execution quality comparison data (an analysis which the entity must perform as part of the annual policy review) should not be part of the policy document itself.

Regarding the definition of "execution arrangements" used by the Directive, this Committee considers that the term "arrangements" is generic and does not seek to encompass more obligations for entities than those already set out expressly in the Directive. Therefore, the "arrangements" would consist of (i) drafting a best execution policy, (ii) exercising appropriate ongoing oversight over compliance with that policy, (iii) monitoring the results of the policy in the terms established by the Directive, and (iv) reviewing the policy once per year or whenever a material change of circumstances requires it.

Therefore, the term "arrangements" should not be construed in the sense that there are other additional best execution obligations apart from those set out above.

This Committee considers that the best execution policy plays a central role in the attainment of the (reasonable) outcome of best execution by entities. Its importance is such that the other arrangements listed above revolve around it and their goal is to monitor compliance with the policy and the policy's suitability to the goal of best execution.

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?

This Committee understands that a best execution policy must necessarily combine both aspects. On the one hand, individual treatment of clients on the basis of their needs and interests in executing an order or a set or class of orders, and, on the other hand, the necessary standardisation of solutions where needs and interests are similar.

The second aspect is covered appropriately in the Directive by the assumption that, in the case of medium-sized retail orders, the needs and interests are determined by the explicit costs of the transaction, comprising price and added costs (of execution, settlement, etc.).

As regards the first aspect, we believe that other factors such as speed, likelihood of execution and likelihood of settlement, market impact, etc. should be considered as truly implicit costs are analysed in the light of the client's specific needs and interests. This implies that (i) it is not possible to establish more specific criteria a priori, and (ii) in any

event, these factors need not generally be considered in the case of retail clients, for whom the Directive considers that price and explicit costs are the relevant factors.

Therefore, this Committee considers that retail clients should be treated uniformly as regards considering mainly the total transaction cost and only in specific exceptional cases where there is a strong justification in terms of needs and interests expressed specifically by the retail client should entities take account of factors other than price and explicit costs.

This Committee also shares the opinion expressed in the CESR document about professional clients: (i) the issues of cost and explicit price are the main factors, in general; and (ii) consideration of any other factors must be discussed beforehand with the client. The Committee considers that this analysis should be made in the light of the needs and interests expressed by the entity's client so that, absent any such expression by the client, the entity will comply with the Directive by providing reasonable best execution in terms of price and explicit cost.

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

The Committee will take advantage of this answer to comment on paragraphs 31 to 37 of the Document.

Regarding the inclusion of fees charged by the entity itself in choosing an order execution venue, we believe that the CESR Document lends itself to an overly restrictive interpretation with regard to allowing entities to charge different amounts for execution at different venues "unless the difference reflects a difference in the cost to the firm".

It is not often easy for a firm to quantify the difference in costs of executing at one venue or another since this is generally a comparison not between direct costs but between expenses arising from an analysis and allocation of costs that are always subjective.

The Committee considers that the rule's goal is to avoid unjustified discrimination between trading venues. Nevertheless, it considers that the justification should not be confined solely to costs (which are hard to measure objectively) but that other factors should be allowed which the regulator considers to be sufficient or, alternatively, that the cost difference should only matter when it evidently has a material impact on the efficiency of the best execution policy.

A restrictive interpretation (like that apparently adopted by CESR in this Document) might lead the widespread, useful practice of flat rates to be considered a violation of the best execution principle.

That is, if the only criterion that justifies charging a different fee for execution at one venue or another is the cost to the entity of operating at each venue, then it might be concluded that charging a flat rate for execution at either venue, where the costs for the entity of the two venues are different, is a violation of the best execution principle.

This Committee considers that strict application of the cost criterion: (i) is hard to monitor and audit, and (ii) introduces uncertainties about practices such as those mentioned above, which we consider do not violate the best execution principle because of their low materiality.

Consequently, this Committee considers that the CESR should state that the justification of different fees for different execution venues must be satisfactory to the regulator, which should check that they do not violate the best execution principle.

Regarding Question (3), this Committee considers that the use of a single execution venue for a specific class of securities is not only possible but may, at present, be the best way to ensure true best execution for reasons, not just of price and cost, but also of liquidity.

Accordingly, the CESR's position in this connection is appropriate in that it considers that identifying a single execution venue in the best execution policy is compatible with the best execution principle, subject to the general principle that this must be based on a prior analysis by the entity.

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

The Committee shares CESR's opinion on this point.

DISCLOSURE

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?

The Committee will take advantage of this question to comment on paragraph 47 of the Document.

Regarding paragraph 47, it should be made clear that the standard of sufficient disclosure should be for the average investor in the class and not for the specific client in question. A level of information that is objectively sufficient should be considered as being sufficient. Entities should not be required to ensure that the information has been "effectively assimilated" by the client since that is not a standard that the entity can measure.

Regarding question 5, we consider that a firm should not, in any case, be required to provide more information to a client than required by article 46 of Directive

2006/73/EC. This is the information that is relevant to enable the professional client to form an opinion, and there is nothing to suggest that such a client is entitled to demand additional information.

This committee agrees with the CESR in that the level of detail to be provide to a professional client on request is determined by the reasonableness of the request, and it considers that this should reasonably be agreed upon between the entity and the client.

The Committee considers that a professional client knows beforehand which factors he wishes to take into account in order to define best execution of his order, so he knows what he is looking for in executing a specific transaction. Since this is a relationship between professionals, each with their own capacity to make decisions and analyse execution quality, the professional client should not be given more protection than the Directive affords to retail clients.

Therefore, the Committee considers that firms should not be obliged to give professional investors more information than retail investors. However, it should be possible to provide such additional information to a professional client, where reasonable, if agreed upon by the two parties.

CONSENT

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

It would be interesting for CESR to clarify that the client's consent to the best execution policy should refer to the part of that policy affecting him, and that firms should not be required to evidence the consent by every client to the entire best execution policy whereas some sections will foreseeably not be applicable to that particular client.

Therefore, the Committee considers that the proper approach is that the client should consent to the entity's execution policy as it affects him, and not generally.

Apart from that, the Committee shares the CESR's approach in that it is necessary to define what is meant by "prior consent" and "express prior consent". The Committee also agrees that "prior consent" may be tacit (in the terms set out in the CESR document), whereas "express prior consent" must be explicit, as follows from the Directive.

However, the Committee considers it positive to provide entities with a more detailed guide by including at least the following criteria into the CESR document:

- When a trade is to be executed outside a MTF or regulated market, the client's express consent should be evidenced in the form of a signature on the order, if such form of execution is expressed in the order.

- Consent should be considered to be express for the purposes of article 21 (4) of the directive when the execution policy delivered to the client clearly indicates the type of order that he is giving the entity, provided it is to be executed against the entity's own book or via a systematic internaliser.
- Express consent can be given for a type of transaction or security and need not be obtained for every single specific transaction. This approach provides the client with sufficient protection in connection with what is sought under the Directive, i.e. (i) the client gives express consent, and (ii) there is assurance that such consent was given voluntarily and upon reflection.
- Recordings of telephone conversations where the client gives express consent should be accepted as sufficient proof of such consent.

CHAIN OF EXECUTION

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

CESR's general approach regarding the role of the entities in the chain of execution is appropriate.

However, the Committee considers that the document does not adequately reflect the fact that each entity is an eligible counterparty for the next entity in the chain and, therefore, is not covered by the best execution principle.

For that reason, an entity should not be required to analyse the best execution policy of the entity to which it transmits the order; rather, the two entities should have established appropriate agreements so as to guarantee best execution or transmission of the orders from clients of the preceding entity in the chain.

Thus, when an entity A receives an order from a client and transmits it to entity B for B to execute or transmit to entity C, it is irrelevant for A to be aware of B's best execution policy since B is an eligible counterparty for A and, therefore, B is not obliged to apply the best execution principle to orders from A. What matters with regard to A's compliance with its own best execution principle as portfolio manager or receiver and transmitter of orders (RTO) is that it has reached an agreement with B governing how B will execute orders received from A. Between firms, it is such agreements that define best execution/transmission orders (not B's best execution policy).

REVIEW AND MONITORING

The Committee has no comments on this section of the document.

EXECUTION QUALITY DATA

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?

It is generally easier to evaluate the price at which a client order was executed, on the one hand, and the prices at which similar orders were executed at the same time at other execution venues, on the other hand. This comparison should be made by each entity in the form that it considers to be most appropriate, which may include sampling or similar procedures. In this connection, the Committee shares the opinion set out by CESR in paragraph 86 of the Document.

Such aspects as execution speed and likelihood of execution or settlement cannot be checked except by more general analyses of the liquidity of alternative venues and the workings and features of the various related or available settlement venues. Therefore, it is not reasonable to assume that a comparison of venues from the standpoint of best execution can be performed on a trade-by-trade basis; rather, the comparison must be based on a venue's general performance.

The Document includes a Call for Evidence about information available for firms at present and what information would be required to measure execution quality.

The Committee considers that the information available at present (i) does not refer to the context of checking execution quality, and (ii) does not refer to the context of decentralised trading. For that reason, the information available at present differs, in terms of scope, sources and purpose, from what firms would need in order to appropriately review their best execution policies.

Therefore, in the new context of best execution designed by the Directive (i) firms need access to historical data of trade execution conditions, (ii) such historical data should refer to trades executed at all venues in the European Union where trades were executed in the security in question, whether MTFs, regulated markets, systematic internalisers or against the entity's own book, and (iii) firms should have ready access to that information on commercially reasonable terms.

The Committee encourages CESR to play an active, relevant role in developing a situation in which these factors obtain.

OTHER ISSUES

The Document includes a Call for Evidence about approaches to data retention requirements for firms in order to evidence compliance with their best execution policy.

The Committee considers, in accordance with the Directive, that a client is entitled to have a firm prove that it acted in accordance with its best execution policy (the policy that was described to the client and to which he gave his consent) but the Directive does not grant clients the right to check that the trade was executed in the best market

conditions at the time and in the circumstances. The latter objective would be attained in the scheme designed by the Directive through the appropriate design, review and oversight of the best execution policy.

It follows, therefore, that entities must be in a position to prove to clients that their trade was executed in accordance with the best execution policy; for that purpose, entities should not have to keep information about alternative prices of its clients' trades.

Therefore, the Committee considers that this obligation for firms does not mean that they must keep historical data of execution prices at other venues.