



ASSOGESTIONI

associazione del risparmio gestito

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Response to CESR public consultation on Best execution under MIFID

Assogestioni¹ thanks CESR for the opportunity to express its views on the issues identified in CESR public consultation document concerning the operation of MIFID rules on best execution set in Directive 2004/39/EC (hereafter Level 1) and its Implementing Directive 2006/73/EC (hereafter Level 2) (ref: CESR 07-050b).

Preliminary to our specific comments and answers, we would like to submit the following general considerations with regard to the proposed guidelines.

1. General remarks

We would like to stress our appreciation for the efforts made by CESR in order to clarify the important and difficult issues that are the object of this consultation paper. However we are disappointed to note that CESR has interpreted MIFID provisions without sufficiently tackling the differences that exist between the activities exercised by firms that execute orders and are subject to Article 21 of Level 1 and the activities exercised by firms that place, receive or transmit orders with other entities for execution which are subject to Article 45 of Level2.

We observe that CESR's outlined views on the parallel interpretation of Article 21 and 45 are almost exclusively oriented towards clarifying the actual operativeness of the discipline contained in Article 21. Hence, we find that at present the proposed guidelines have missed the long and eagerly awaited opportunity to clarify the positive actions that investment firms should take in order to comply with para.1-6 of Article 45. This causes great confusion and generates dangerous doubts in relation to the definition of the exact responsibilities of different market operators.

Above all we find CESR's outlined views with regard to execution chains very equivocal and cryptic. The actual contents of the legal responsibilities of the various investment firms belonging to the execution chain remain still uncertain with clear practical dangerous consequences for all financial markets operators and, in particular, for portfolio managers that place orders with other intermediaries for execution.

¹ Assogestioni is the Italian association of the investment fund and asset management industry and represents the interests of 148 members who currently manage assets whose value exceeds 1.100 billion euro. Our members are both directly and indirectly affected by the issues involved in the implementation of MiFID discipline.



Finally, we think that CESR's treatment in respect to the application of best execution requirements to the service of dealing on own account (in consideration of Recital 69 of Level 2) is not adequate and that this area would deserve further attention by CESR for the proposition of specific guidelines.

2. Specific remark and answers to CESR's questions

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 be 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?*

Article 45 "execution" policy. As a preliminary remark, we note that it is not clear the relationship between Article 45 "execution policy" adopted by portfolio managers when placing client orders with other entities for execution and Article 21 "effective (execution) arrangements" implemented by investment firms when executing client orders.

We refer to para. 21 of the consultation document, where CESR's states that Article 45 "policy" implies procedure for best execution implementation *and is analogous to the Article 21 "execution arrangements"*, further indicating that its content should include "similar elements" to those contained in Article 21 "execution policy".

In particular, if it is quite obvious that implementation of Article 45 execution policy implies the adoption of *procedures* for implementation of the specific best execution obligations that portfolio managers must realise when placing orders, it is important that CESR clarifies that the lack in Article 45 of any equivalent wording or cross reference to Article 21 entails that the "implementing procedures" to be adopted by portfolio managers when placing orders are clearly *not* analogous measures to the "execution arrangements" implemented by firms when executing orders.

The main issues to be addressed in an (execution) policy. With reference to the first sub-question, we disagree with CESR's inclusion amongst the main issues that the execution policy must address of a *description of the investment firms' "execution approach" for carrying out orders for execution from their origin to their execution or settlement* (see letter a, at para. 22 of the paper).

We object that this expression is too vague and stress that – in contrast with CESR's understanding - it is not prescribed by any MIFID Level 1 or 2 provision. Its inclusion would therefore be in contrast with CESR's declared intention not to use its opinion to make new rules. Moreover, we do not understand the rationale behind the proposed description, given that MIFID rules require investment firms to *establish*



and enact effective implementing measures or arrangements to reasonably achieve the best possible results.

We further bring to CESR's attention the fact that such a description would be impossible in case of delegation of portfolio management and invite CESR, if it insists in the proposal of this issue, to consider and properly clarify this important practical case.

Finally, with regard to the remaining issues identified in letters b, c, and d of para. 22 of the paper, we object that these contents are expressly required only for Article 21 execution policy. All that Article 45 establishes in relation to the execution policy that must be adopted by portfolio managers (and RTOs) is that "the policy shall identify, for each class of instruments, the entities with which the orders are placed or to which investment firm transmits orders for execution".

Article 21 execution policy. With reference to the second and third sub-questions, we agree with CESR's views provided they are referred to Article 21 execution policy. As already outlined above, the proposed interpretation is not valid for Article 45 (execution) policy because the execution procedures that portfolio managers must establish are not equivalent measures to the executive arrangements that execution firms must implement according to Art. 21.

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 have no specific comments on this question.

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

Possibility of a single execution venue. We find that CESR has correctly identified and outlined this issue in the considerations made at para. 40 of the consultation paper, where it clarifies that "portfolio managers or RTOs may achieve a more advantageous total consideration for its clients by directing all orders to an affiliated firm within its corporate group if it can provide the best possible result on a consistent basis and enable the portfolio manager to charge lower fees or commissions " (subject to the require monitoring and reviews).

In respect to the this statement, we ask CESR to clarify whether the expression "*charge lower fees or commissions*" refers to management fees or to dealing fees.

Professional clients. We agree with CESR's view that if on the one hand investment firms remain responsible for determining the weight they attribute to the Article 21(1) execution factors in their execution policies and arrangements, on the other



hand the concept of “total consideration” will be very relevant in practice for the assessment of best execution for professional clients in most cases, although there will be circumstances in which other factors will be more important.

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

Yes.

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 request? 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?*

Firstly, with respect to *ex post* disclosure requirement, we stress that this duty is only imposed by Article 21 on investment firms that execute orders; there is no equivalent rule imposed by Article 45 on portfolio managers and RTOs.

Secondly, we believe that the evaluation of what is the “appropriate” level of information to be communicated to professional clients, should be left to investment firms and to the commercial relationship established by investment firms with this type of clients i.e. when complying both with the *ex ante* communication and *ex post* disclosure requirement. This is in consideration of the fact that - as reflected in Recital 31 of Level 1 - the *ratio* behind the distinction between different investors categories (retail, professional, qualified) is to differentiate the level of protection granted by MIFID requirements to their respective real needs. Recital 44 of Level 2 further clarifies this principle, establishing the general principles of proportionality and appropriateness of information requirements and of proportionate balance between investor protection and any disclosure obligation imposed on investment firms, and establishes that “*to this end, it is appropriate that less stringent specific information requirements be included in this Directive with respect to professional clients. 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 investment firms to provide such information. Where such information are reasonable and proportionate investment firms should provide additional information*”.

Accordingly, with regard to the first part of this question, we ask CESR to clarify that:

- (i) the definition of the “appropriate” level of information for professional clients is always at the discretion of investment firms;
- (ii) only Article 21 firms (not Article 45 firms) are subject to the *ex post* disclosure duty to respond to reasonable and proportionate requests (according to Article 21(5) of Level 1 and Recital 44 of Level 2); whilst any *ex post* communication of information to professional clients by portfolio



managers that are subject to Article 45 is facultative and left to the definition of their business relationship with such clients.

As to the second part of question no. 5, we note that there might be circumstances in which the request by a professional client to an Article 21 firm to provide more information than it is required to be provided under Article 46(2) of Level 2 *may be* reasonable and proportionate. However CESR should not impose a new rule by requesting such a disclosure as this should also be a matter whose definition must be left to the commercial relationship established by an investment firm with its professional client.

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?*

Yes.

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

We find that CESR has correctly identified the different circumstances in which a portfolio manager can operate in an execution chain when placing orders for execution with other entities which may or may not be subject to Article 21 best obligation requirements. However we also find that CESR’s indications are not sufficiently clear, allowing room for different interpretations on what are the specific limits of the responsibility of portfolio managers in the execution chain (when they don’t give specific instructions).

CESR has clearly illustrated that Article 45 best execution discipline consists of a best selection obligation and of a subsequent “appropriate” monitoring obligation, in that it requires portfolio managers:

I) as a first step to include in their execution policy those entities that enable them to comply with their obligation to obtain the best possible result for their clients taking into account Article 21(1) factors. With respect to this best selection obligation, we support CESR’s view that what is *reasonable* to impose on investment firms, according to the reasonableness test set by Article 45, is an evaluation only of the entities’ execution approach, not of the actual execution arrangements put in place by those entities: portfolio managers must evaluate which entity’s execution quality delivers consistently those best possible results that they must ensure according to their execution policy.

II) as subsequent step to keep these approaches under review “*as appropriate*”. To this end we believe that it would not be *reasonable* to impose on portfolio managers additional monitoring and reviewing obligations (or with more frequency) to those that are already required by Article 45. Accordingly, we ask CESR to clarify that this reviewing requirement resolves itself into compliance with the monitoring and reviewing requirements contained in Article 45 (6).



It follows that Article 45 establishes a legal presumption to the effect that if portfolio managers comply with the two above illustrated best executions obligations, they have satisfied all Article 45 best execution requirements. Any additional or different requirement would be beyond what is required by MIFID. Hence portfolio managers can make *full reliance* on all intermediaries selected according to their best selection obligations provided they keep monitoring the intermediaries' execution quality and perform the review according to Article 46 (6) of Level 2. We stress that this conclusion is valid *either* when portfolio managers are treated as eligible counterparties (see para. 65 of the paper) *or* when they use third country intermediaries that are not subject to MIFID best execution requirements (see para. 74 of the paper): in those cases it should be clear that the degree of responsibility of portfolio managers is the same and that what differs is only the extent of the evaluation that portfolio managers must perform with respect to the execution arrangements or standards of execution quality that will allow them to comply with Article 45.

On the basis of the above made considerations, we strongly disagree with CESR's opinion expressed in para. 65 that "*MIFID's best execution requirements should be applied as necessary to take into account the particular function performed by each firm in the chain*". Article 45 best execution discipline does not allow for any distinction in this respect because – as illustrated above – it clearly prescribes and limits the content of a portfolio managers' best execution obligations. We also object to the opinion contained in par. 72 according to which a portfolio manager that uses an intermediary subject to Article 21 for the executions of its clients orders will not be able to place *full reliance* on that intermediary in order to comply with its own best execution requirements but only a "*high degree of reliance*" provided that "*certain conditions are met*" and that "*the intermediary complies with Article 21*". In our opinion the statement contained in this paragraph is cryptic and tends to shift the balance of the responsibility in favour of Article 21 intermediaries. It is not required for portfolio managers to ensure that Article 21 requirements are always satisfied by the intermediaries with which the orders are placed.

We understand that MIFID rationale for imposing Article 45(5) best execution requirement is to select those execution entities that will be able to offer efficient execution arrangements or standards of execution. Furthermore, Article 45 (5) clearly indicates that portfolio managers (and RTOs) owe best execution obligations *either* under Article 21 *or* 45, depending on whether they also execute their clients order. We therefore do not understand in which cases "best execution responsibilities overlap" (see para. 75 of the document) and find CESR's conclusion that it is possible for a firm to determine "*how far the execution standard delivered by an intermediary at the following point of the chain goes in satisfying the best execution that apply to itself*" very confusing and substantially wrong.

Finally and in relation to the case when portfolio managers place orders for execution with an intermediary that is not subject to Article 21 best execution requirement, we ask CESR to consider that the way in which some markets operate today is characterised by a lack of information on intermediaries' execution quality data. This situation makes very difficult in practice for portfolio managers to satisfy themselves that those intermediaries have execution arrangements or standards of



execution quality that enable them to comply with Article 45 requirements. We stress that the necessary transparency can not be achieved today through the contractual power of portfolio managers.

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?

Portfolio managers and RTOs have to monitor the “execution quality” of the entities they select for their policies. In order for this monitoring process to be effective, we acknowledge that much information should be available. Unfortunately, there are many circumstances in which this is not clearly the case. In particular, we are referring to the dealer markets and to the case in which the intermediaries that deal in a specific instrument are not subject to MiFID.

We believe that this issue should be addressed in the light of the debate on the MiFID non-equity market transparency and in particular on the basis of the responses CESR is receiving to its call for evidence (CESR/07-108).

Appropriate level of transparency for non-equity products depend on many different factors (market segment size, trading frequency, participants, credit ratings, trading methodology, etc.). As a consequence we don't think that a one-size-fits-all solution does exist.

However, we understand that some proposals are around that call for a “market-led” solution to the non-equity transparency issue and that are based on the idea that the issuers should fix the trading transparency regime for their issues. Should this be the case, portfolio managers could eventually benefit from a much easier access to trading information on those products whose issuers are willing to commit to an adequate level of trading transparency.

Call for evidence on Data Retention implications of Article 21(5) of Level I demonstrating compliance)

Once policies and procedures are well in place, demonstrating compliance results in showing that the firm follows them on a firm basis. However, this does not mean that the firm has to retain available prices or quotes for every transaction.

The Director General