



STATE STREET

The Committee of European Securities Regulators
11-13 Avenue de Friedland
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March 16, 2006

**RESPONSE TO CESR / 07-050b: CONSULTATION PAPER ON BEST
EXECUTION UNDER MIFID**

State Street Corporation, headquartered in Boston, U.S.A., specializes in providing institutional investors with investment servicing, investment management and investment research and trading. With \$10.9 trillion in assets under custody and \$1.5 trillion in assets under management State Street operates in 26 countries and 100 markets worldwide. Our European-based workforce of over 5,400 employees represents 20% of our global headcount.

Dear Sirs, dear Madams,

State Street Corporation would like to thank CESR for the opportunity to comment on the Consultation Paper on best execution under MiFID. Please find attached our answers to the questions posed.

We would be happy to discuss with you, in further detail, any comments you may have. Please do not hesitate to contact Gabriele Holstein at 0041 44 560 5101.

Sincerely,

Stefan Gavell
Executive Vice President
Industry and Regulatory Affairs

Dr. Gabriele Holstein
Director of European Industry
and Regulatory Affairs

**State Street Corporation's response to questions in the CESR
Consultation Paper on Best Execution under MIFID
(CESR / 07-050b) (the "Consultation Paper")**

Introduction

This memorandum contains State Street's response to the overall content and the specific questions set out in CESR's Consultation Paper. We welcome CESR's effort to promote supervisory convergence in regards to the implementation of best execution requirements under MiFID and to ensure compliance with agreed upon standards.

Please note that State Street's businesses engage in the following MiFID related activities on behalf of institutional clients:

- (i) As an asset manager providing *portfolio management services*, we make and implement investment decisions for portfolios held in custody accounts maintained in the name of the client. This includes implementing investment decisions through agency transactions with selected broker-dealers.
- (ii) As a provider of *transition management services*, we make and implement trading and other investment decisions in relation to the transitioning of portfolios held in custody accounts maintained in the name of the client.
- (iii) As a provider of *non-discretionary trading services (NTS)*, we route transactions upon receiving customer instructions via an electronic communication system.
- (iv) As a *broker*, we execute buy / sell orders relating to securities and futures as an agent for our clients on regulated markets.

Given the nature of our business, State Street would like to comment on the best execution requirements discussed in the Consultation Paper as they relate to the content of execution policies and arrangements, client disclosure, client consent, chains of execution, as well as the review and monitoring obligations of investment firms.

State Street's detailed responses to the specific questions posed in the Consultation Paper follow below.

EXECUTION POLICIES AND ARRANGEMENTS

According to Article 21 of MiFID and Article 45(4) of the Implementing Directive, investment firms subject to MiFID's best execution requirements are to take all reasonable steps to obtain the best possible result for the execution of client orders, taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. To implement this overarching requirement, the following conditions must be met:

Investment firms that *execute client orders* subject to Article 21 must: (i) put in place "arrangements" including an "execution policy" so as to take all reasonable steps to obtain the best possible result for the execution of client orders; (ii) obtain client consent to the execution policy; and (iii) be able to demonstrate on a client's request that they have executed the order in compliance with the execution policy.

Investment firms that *receive and transmit client orders* ("RTOs") or *place orders with entities for execution in the course of managing portfolios for clients* ("portfolio managers") subject to Article 45 must implement a "policy" to achieve the best possible result for client orders. There are, however, no requirements for client consent or demonstration of compliance to clients.

In addition to the above, all investment firms must: (i) disclose "appropriate information" to clients about the firm's (execution) policy; (ii) monitor compliance with the policy as well as whether the approach allows for the best possible results for clients; and (iii) review their execution approach, execution venues or entities they use on a regular basis, whenever a material change occurs and at least annually.

Q1: 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 a 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?**

We agree with CESR's view that the execution policy specified in Article 21 of MiFID is designed to set out the most important and / or relevant aspects of a firm's execution arrangements and is to be regarded as a distinct part of the firm's overall execution approach.

Furthermore, we welcome CESR's clarification in respect to the main issues that a firm is to set out in its execution policy. We agree with the list of issues as laid out in paragraph 22 of the Consultation Paper as they relate to investment firms that *execute client orders* pursuant to Article 21.

In regards to CESR's statement that the execution policy of RTOs and portfolio managers pursuant to Article 45 of the Implementing Directive are to a large extent similar to the execution policy specified in Article 21 of MiFID, we, however, feel that more clarity is required as to the circumstances under which portfolio managers may need to retain responsibility for best execution. We would argue that this is the case in the following instances as they relate to the cash equity market:

1. The portfolio manager makes a decision that a principal transaction for an entire order will achieve a better result than an agency trade which would take place over a longer time frame. The chosen dealer should not have an obligation as he is simply being asked to quote as principal his best price at that point in time. The manager is at liberty to accept or reject this price.
2. The portfolio manager has a portfolio trade to undertake and decides to ask several competing dealers to bid on a blind basis. The lowest price wins. The manager must

accept responsibility for this decision, and the dealer is simply quoting a price that he feels comfortable would result in a suitable reward for the risk taken should he win.

3. The portfolio manager uses Direct Market Access (DMA) technology via the dealer and determines parameters of the algorithmic trade. The dealer plays no part in determining these parameters, and is just providing a conduit to the exchange.

In fixed income and foreign currency markets, which are commonly principal markets driven by quotes, a dealer approached by a portfolio manager for a quote has not taken any obligation to act on behalf of the manager and hence does not owe him a best execution obligation. This also would still be the case if the dealer executed the transaction, as the manager is at liberty to accept or reject the quote.

Q2: 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?

State Street only services institutional clients, and as such, is not in a position to comment on this question as it relates to retail clients. Generally speaking, we feel that the concept of implicit costs is difficult to implement as such costs are difficult to calculate and that it should therefore be reconsidered.

Furthermore, we are concerned by CESR's view stated in paragraphs 28 to 30 of the Consultation Paper of applying the concept of "total consideration" to professional client orders, in particular CESR's statement that "price and cost merit a high relative importance in obtaining the best possible result for professional clients". While we view price and costs as factors important to all clients groups, there are, as outlined in MiFID, circumstances where other factors are of equal or even of higher relevance than price and costs. We feel that the position taken by CESR goes beyond the intention of MiFID which considers it to be the responsibility of investment firms

to determine the weight they attribute to Article 21 factors when executing orders from professional clients. We therefore suggest that no weighting of the factors in Article 21 of MiFID is recommended and that investment firms remain free to weigh the factors at their own discretion depending on their business model and type of professional clients they service.

Q3: Do respondents agree with CESR's views on the use of a single execution venue?

In regards to investment firms that *execute client orders*, CESR discussed two circumstances in which investment firms should have the possibility to use only a single execution venue:

- (i) Only one execution venue delivers the best possible result on a consistent basis for certain instruments and orders.
- (ii) A variety of potential execution venues exist, but the costs of accessing more than one of them directly outweighs any price improvement an alternative venue might offer.

We welcome this view, in particular (ii) that the costs of accessing alternative venues are to be considered when setting up an execution policy.

In paragraph 39, CESR proposes that where the investment firm decides not to connect directly to a venue due to the associated costs, the advantages of indirect access (i.e. transmitting its client orders to another execution intermediary rather than executing those orders itself) should be considered. We believe CESR's arguments to be valid and would argue that the costs associated with the indirect access also need to be taken into account.

Q4: Do respondents agree with CESR's views on the degree of differentiation of the (execution) policy?

The MiFID requirement that an execution policy needs to reflect significant variations in its execution approach for each class of instrument, raised questions as to whether investment firms need to create different policies (or different segments of

an overall policy) in order to address different types of trading and dealing, as well as what level of detail such a policy needs to provide.

CESR states that the level of differentiation in a firm's execution policy should be sufficient to enable the client to make a properly informed decision about whether to utilise the execution services offered by the firm. In order to do this, the policy will need to provide a sufficiently detailed description of the execution approach that the firm takes in order to obtain the best possible result for the relevant categories of instruments, orders, clients and markets with which it deals.

We welcome that CESR does not require a specific degree of differentiation and that investment firms have the possibility to choose the level of differentiation that they deem to be appropriate in view of their specific business model and services provided.

DISCLOSURE

Q5: 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?

In the Consultation Paper, CESR draws attention to the fact that while Article 46(2) of the Implementing Directive specifies disclosure requirements for retail clients, there is no equivalent provision relating to "appropriate information" which must be provided to professional clients. Referring to Recital 44 of the Implementing Directive which states that "Professional clients should (...) be able to identify for themselves the information that is necessary for them to make an informed decision, and to ask the investment firm to provide that information," CESR considers that it should be at the investment firms' discretion to determine the appropriate level of information disclosure for professional clients. We agree with this view.

In regards to their duty to respond to professional clients' requests, we believe that investment firms should not be required to provide information beyond what is required under Article 46 (2) of the Implementing Directive. If they provide additional information, they should only do so on a voluntary basis.

CONSENT

Q6: Do respondents agree with CESR on how "prior express consent" should be expressed? If not, how should this consent be manifested? How do firms plan to evidence such consent ?

Article 21(3) of MiFID requires investment firms to "obtain the prior consent of their clients to their execution policy" and Article 21(4) requires them to "obtain the prior express consent of their clients before proceeding to execute their orders outside a regulated market or an MTF." CESR draws attention to the fact that while "prior consent" may in some jurisdictions be tacit, "prior express consent" must be actually expressed by the client.

We agree with CESR's proposal that "prior express consent" may be provided by either: (i) signature in writing or an equivalent means (i.e. electronic signature); (ii) click on a web page; or (iii) orally by telephone or in person. In order to evidence such consent, State Street is currently working on the identification and evaluation of appropriate record keeping mechanisms. At this stage, we are not in a position to provide detailed information as to which solutions will be actually implemented.

CHAINS OF EXECUTION

Q7: Do respondents agree with CESR's analysis of the responsibilities of investment firms involved in a chain of execution?

We agree with CESR that in order to consider whether an investment firm has complied with the requirement to obtain the best possible result for its clients, the role performed by the firm within the chain of execution needs to be taken into account and that these requirements vary depending on the investment service a firm provides.

We further would like to comment on CESR's view in regards to the requirement for an investment firm to monitor whether its execution approach allows the firm to obtain the best possible result for the execution of its client orders.

According to CESR, Article 45 of the Implementing Directive subjects portfolio managers and RTOs to similar review and monitoring principles as firms that execute client orders. Due to their different positioning in the chain of execution, however, different approaches are considered to be required for the firms to fulfill their respective review and monitoring obligations.

According to CESR, *firms executing client orders* need to *review* whether the venues they use are delivering the best possible result for execution of their client orders and *monitor* the execution quality being delivered by the venues which are currently included in the execution policy. *Portfolio managers and RTOs* need to *review* whether the results from firms they use achieve a better result than the results that are being delivered by other firms in the market and *monitor* the execution quality they obtain from the firms and/or venues that are included in their policy.

We do not share CESR's view in regards to the monitoring duties of RTOs and portfolio managers. We believe RTOs and portfolio managers should only be required to monitor whether the intermediary they use has adhered to its best execution policy and / or best execution arrangement. They should not be required to compare the result that the intermediary has delivered to the results that would have been possible with another intermediary.