BEST EXECUTION (MIFID 2)

ESMA'S CONSULTATION ON DRAFT TECHNICAL STANDARDS ON ORDER EXECUTION POLICIES

AMAFI's answer

AMAFI is the trade association representing financial markets' participants of the sell-side industry located in France. It has a wide and diverse membership of more than 170 global and local institutions notably investment firms, credit institutions, broker-dealers, exchanges and private banks. They operate in all market segments, such as equities, bonds and derivatives including commodities derivatives. AMAFI represents and supports its members at national, European and international levels, from the drafting of the legislation to its implementation. Through our work, we seek to promote a regulatory framework that enables the development of sound, efficient and competitive capital markets for the benefit of investors, businesses and the economy in general.

New Article 27 (10) of the revised MiFID II, which was published in the Official Journal on 8 March 2024 and entered into force on 29 March 2024[1], requires ESMA to develop RTS specifying the criteria for establishing and assessing the effectiveness of investment firms' order execution policies. ESMA thus consults on the draft RTS it developed for that purpose.

GENERAL COMMENTS

AMAFI sees merits in RTS that provide details on what is expected of best execution requirements, building on the existing ESMA Q&A[2] and CESR's Q&A on Best execution under MiFID (including *Commission's answers to CESR scope issues under MiFID and the implementing* Directive).CESR's Q&A on Best execution under MiFID (including the *Commission's answers to CESR scope issues under MiFID and the implementing* Directive).

[1]Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202400790
[2] section 1 of Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics.

However, Article 27 of the revised MiFID II[3] does not include the strengthening of the existing provisions on best execution. In this context, AMAFI considers the draft RTS to be far too demanding, in a context where:

- No real impact assessment has been conducted;
- The consultation paper does not identify any poor practices that such stringent requirements would address;
- To our knowledge, there are no market failures regarding best execution rules that would call for strengthening the requirements.

In the light of Mario Draghi's report, competitiveness should be a core objective for the EU and any regulatory initiative should take this imperative into account. As new regulatory requirements impose additional costs on European firms, affecting their profitability and that of their clients, it is necessary to weigh the benefits of regulatory changes against these drawbacks. With respect to the draft requirements of the RTS, this balance is not being struck, which means that European firms will face higher costs to meet their best execution obligations without any clear justification. And this will have a greater impact on small and medium-sized EU investment firms, whose cost base is tighter and cannot easily absorb new layers of costs, while they are the ones who tend to be active on small and mid-caps, i.e. the companies that the EU needs to nurture, as they provide the most jobs and innovation.

The tightening of best execution rules will also lead to more complex execution policies for clients, making them more difficult to understand, which will be particularly detrimental to retail clients, whose savings are precisely those that the EU Savings and Investment Union aims to channel to companies. While such tightening may not in itself deter clients from investing in financial markets through shares, it is an additional hurdle in a context where the proportion of retail clients investing in financial markets is low compared with international peers[4].

Therefore, we strongly advocate for ESMA to stick to the current provisions on best execution disseminated in ESMA's existing Q&As[5] and CESR's Q&A on Best execution under MiFID (including *Commission's answers to CESR scope issues under MiFID and the implementing* Directive)AMAFI therefore considers the draft RTS run counter to the objective of less complex regulation and more competitive EU firms and strongly advocates that ESMA retains the current provisions on best execution, as set out in the existing ESMA's existing Q&As[6] and CESR 's Q&A on Best execution under MiFID (including *Commission's answers to CESR scope issues under MiFID and the implementing* Directive).

[3] in the primary objective of deleting the requirement for RTS 27 and 28

[4] See explanatory memorandum of the Commission's Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directives (EU) 2009/65/EC, 2009/138/EC, 2011/61/EU, 2014/65/EU and (EU) 2016/97 as regards the Union retail investor protection rules

[5] Section 1 of Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics.

[6] Section 1 of Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics.

In particular, AMAFI strongly disagrees with three proposals in the draft RTS:

- **The use of consolidated tape ("CT") data, making it *de facto* mandatory**. This is contrary to Level 1, which is the result of a lengthy debate on the issue of mandatory use of CT data, which was settled by the decision not to make it mandatory, stating that CT data "***can*** *be used for proving best execution*"[7]. This would result in significant additional data-related costs which would be disproportionate for some firms, given their activities and specificities. The issue of data cost is already critical for firms, as data is essential for them to carry out their activities, while current prices are high enough to act as a barrier to entry. Therefore, the use of CT should be a decision left to the firm itself, based on whether it meets its needs at a reasonable cost, and not a regulatory obligation that could give the CT a *de facto* a monopoly on data provision, especially where such an obligation has no legal basis. ESMA is going beyond its legal mandate by indirectly imposing the CT on investment firms.
- **The consideration of historical prices both when determining the execution venues to be included in the execution policy and when determining the execution venue to be selected upon receipt of a client order**. While execution prices are certainly relevant when deciding how to route client orders and when monitoring the best execution policy on an ex-post basis, it is not appropriate to consider historical prices when selecting venues : for illiquid instruments, liquidity is by far the most important criterion to take into account; for liquid instruments, if there are occasional price discrepancies across venues, they tend to be small, temporary, and, more importantly, unpredictable.
- **The definition and assessment of the best execution policy based on categories of financial instruments determined according to ISO 10962 Standard**. It would lead to the assessment of 76 different categories of financial instruments, notwithstanding the creation of categories per country of primary listing. Even leaving aside the feasibility issues raised by such a requirement, it is clear that firms will be unable to provide information "*that can be easily understood by clients"* (*MiFID, Art. 27(5) and ESMA Consultation Paper, Section 3.1, Point 12)* in this context.

Finally, the draft RTS, as proposed, are not flexible enough, applying a "one size fits all" approach to all types of financial instruments, irrespective of their liquidity and the possible existence of market references. For example, Article 6 on the monitoring of the execution quality does not seem to take into account the specificities of OTC bespoke financial instruments for which there is no market data or reference.

[7] Recital 8, Directive (EU) 2024/790 of the European Parliament and of the Council of 28 February 2024 amending Directive 2014/65/EU on markets in financial instruments

Q1: Do you agree with the proposed categorisation of classes of financial instruments? And could the methodology based on, inter alia, the classification of financial instruments in the MiFID II RTSs 1 and 2 be used in the context of MiFID II transparency reporting be an alternative? Please state the reasons for your answers.

No. The proposal to distinguish between the different classes of financial instruments based on the first two letters of the CFI code of ISO Standard 10962 is too burdensome. It would require 76 different categories to be distinguished, notwithstanding the creation of categories per country of primary listing, which is hardly workable. This additional burden lacks foundation in the absence of identified shortcomings stemming from the level of granularity that was required under Annex I of former RTS 28.

It would also make best execution policies difficult to read for clients who already complain about the excessive amount of information provided to them, especially where MIFID and ESMA itself insist on the overarching principle pursuant to which information must *"be easily understood by clients"* (*cf. supra*).

AMAFI therefore advocates simplicity by reverting to the previous categorisation of financial instruments used in RTS 28. The one used in current RTS 1 and RTS2 would not provide for a good basis as it is too granular. As a precautionary measure, investment firms could be required to add a new category if they identify particularities in the execution modalities for some specific types of financial instruments.

Q2: Do you believe that the current wording of the RTS is clear and sufficient with regard to the content of the order execution policy where an investment firm selects only one execution venue to execute all client orders? Or should the RTS provide for specific criteria to be taken into account when assessing if the selected venue achieves the best possible result in the execution of client orders? Please also state the reasons for your answer

Yes. Recitals 3 and 15 of the draft RTS reintroduce the main clarifications brought by question 3 section 1 of the Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics.. Such recitals provide sufficient guidance on how to proceed when selecting a unique execution venue.

Q3: Do you agree with the proposed factor of "order sizes" respectively for retail and professional clients, to be considered in investment firms' selection of eligible execution venues in their order execution policy and internal execution arrangements (see Article 4(1) (d) (i and ii) of the draft RTS)? If not, what alternative factor would you propose?

Generally speaking (see next answer), AMAFI questions the idea of comparing execution prices to historical reference data set for the purpose of selecting execution venues.

That said, we agree that order size *per se* is definitely a relevant criterion when it comes to best execution.

However, Article 4(1)(d) i) and ii) of the draft RTS require not only different "*order values*" to be taken into account, but also "*different frequencies"*, while it is unclear whether they should be considered

together or not[8]. Moreover, these criteria must be combined with client and financial instruments categories for the purpose of determining (and then assessing) the firm's best execution policy.

Article 4(1) (g) i)[9] seems to require firms to compare execution prices for different asset classes, order frequencies and values, with prices observed on potential execution venues, by using a consolidated dataset of reference prices per asset class. If this interpretation is correct, the work to be undertaken will be extremely burdensome: comparing execution prices with reference prices for each asset class (potentially 76), for retail and professional clients, and for each type of clients for different frequencies and values. This would result in at least[10] 304 different calculations based on as many sets of data, without even taking into account financial instruments that are primarily listed in foreign jurisdictions.

In these circumstances, we do not see how to provide clients with a best execution policy that they will be able to understand.

This proposal clearly contravenes the general principle of proportionality underlying EU law, as it imposes measures that are excessively burdensome in relation to the objective sought, all the more so as no cost-benefit analysis has been carried out in relation to the proposed RTS.

Q4: Do you agree with ESMA's proposals for the specification of the criteria for establishing and assessing the effectiveness of investment firms' order execution policies? Please also state the reasons for your answer.

As for the criteria for establishing the firm's execution policy, draft Article 4 raises significant concerns:

- Firstly, it appears to confuse the "*best execution factors*" of Article 27(1) of MiFID[11] with the expected level of granularity of the execution policy, by class of financial instruments, required by Article 27(5) of MiFID:
    - The "*best execution factors*" are criteria against which the "*best possible result*" in executing client orders required by Article 27(1) should be determined, i.e., in general, price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.
    - In contrast, classes of financial instruments of Article 27(5) are a necessary level of detail to be provided in the best execution policy, in order to inform clients for each of these classes, of the different venues where their orders are executed and of the factors affecting the choice of execution venue.

[8] Meaning either:
- several order values for one frequency, with different assumptions on frequency or
- several assumptions on both order value and frequencies

[9] For the purpose of establishing its order execution policy on the initial selection of execution venues, an investment firm shall take into account the characteristics and needs of the clients to which it provides investment services, including:…
(g) for the criterion of price:
(i) for each class of financial instruments, an assessment of the execution quality that compares the execution prices of potential execution venues to be selected with a consolidated dataset of reference prices; …

[10] It would be 608 in case order size and frequency were to be treated separately.

[11] price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.

Therefore, for the requirement to be understandable, Article 4 should make a clear distinction between the two sets of factors: on the one hand, factors against which best execution should be assessed and, on the other, classes of financial instruments on which granular information is provided in the execution policy assessment.

- We also question the chapeau of Article 4(1) that states that "*an investment firm shall take into account the characteristics and needs of the clients to which it provides investment services*" because it reads as an obligation to take into account all types of client needs[12] and not only those relating specifically to the execution of orders, which does not make sense.

Article 4(1) (g) i) seems to require firms to compare execution prices for different asset classes, order frequencies and values, with prices observed on potential execution venues, by using a consolidated dataset of reference prices per asset class. If this interpretation is correct, the work to be carried out will be extremely burdensome: comparing execution prices to reference prices for each asset class (potentially 76), for retail and professional clients, and for each type of client for different frequencies and values. This would result in at least 304 different calculations, based on as many sets of data, without even taking into account financial instruments primarily listed in foreign jurisdictions. Once again here, this proposal clearly contravenes the general principle of proportionality underlying EU law, as it imposes measures that are excessively burdensome in relation to the objective sought, all the more so as no cost-benefit analysis has been carried out in relation to the proposed RTS.

- More generally, AMAFI strongly opposes the requirement to assess the price factor at the stage of the selection of the execution venues by comparing "*the execution price of a potential execution venue to be selected with a consolidated dataset of reference prices". S*uch comparison is very unlikely to provide any useful information, as in practice:
    - For liquid financial instruments (mainly equities), which are usually traded on trading platforms, if there are occasional price discrepancies (usually called "market noise"), they tend to be small, temporary, and, more importantly, unpredictable. The intervention of arbitrageurs on the trading platforms usually leads to price convergence.
    - For illiquid financial instruments, price is not the best criterion, as liquidity, rather than price, is the main driver for selecting an execution venue. While price is undoubtedly a very relevant criterion for determining the execution venue to which the client order is to be routed upon receipt of the order, it does not make sense to include it in the firm's policy at the stage of venue selection. On the contrary, the liquidity criterion, as a measure of speed, likelihood of execution and expected price[13] is more relevant.Indeed, liquidity will typically have an impact on price, as the more liquidity the venue offers, the less adverse price movements are likely to negatively impact the execution price.

[12] In the sense of suitability requirements
[13] The 3 criteria against which best execution should be assessed, according to Article 27.1 of MiFID II

- Furthermore, as stated in our Generall Observations on page 2, AMAFI totally disagrees with the requirement, under Article 4(2) to "*use the consolidated tape data or alternative datasets, provided the alternative dataset provides at least the same reference data quality as the consolidated tape (CT) data".* This requirement amounts to a *de facto* obligation to use CT data, as it is very unlikely that investment firms would be willing to take the risk to assert that an alternative dataset is *"providing at least the same reference data quality as the consolidated tape"* - for a very simple reason: given the requirements the CT is subject to, the likelihood of an alternative dataset being of the same standard is close to zero. This is not in line with the Level 1, which only mentions the CT as a *possible* tool for assessing best execution: ESMA is going beyond its legal mandate by indirectly imposing the CT on investment firms.

  Finally, the intention behind the criterion c) of Article 4(1), "*investment amount*" is unclear: it seems to duplicate the requirement under d) of Article 4 (1) to take into account the "*typical value of orders*".

AMAFI therefore suggests that Article 4 be completely redrafted to make it clear, proportionate, workable in practice by investment firms and consequently enforceable to the benefit of clients.

Q5: Do you agree with ESMA's proposal that investment firms may rely on monitoring and assessments performed by third parties, such as independent data providers, as long as firms assess the processes of these third parties? Please also state the reasons for your answer.

Yes. In any case, the use of a third party for such monitoring may be subject to the MiFID requirements on outsourcing of critical and important operational functions[14], including the requirement to assess the third party's ability to perform the outsourced tasks.

Q6: Concerning the specific client instruction, should it be possible for an investment firm to pre-select an execution venue in the order screen, where the firm invites its clients to choose an executing venue out of multiple options? And if so, do you agree that only if the client chooses a different venue than the one pre-selected by the firm, the choice of execution venue does constitute a specific instruction? Please also state the reasons for your answer.

The suggested practice does not seem to be widely spread and Recital 102 of Regulation (EU) 2017/565[15]as well as EC's Q&As of 2007 look sufficient to us to address this issue.

[14] In the sense of Article 31 (2)(a) of MiFID2 Delegated Regulation

[15] "*An investment firm should not induce a client to instruct it to execute an order in a particular way, by expressly indicating or implicitly suggesting the content of the instruction to the client, when the firm ought reasonably to know that an instruction to that effect is likely to prevent it from obtaining the best possible result for that client. However, this should not prevent a firm inviting a client to choose between two or more specified trading venues, provided that those venues are consistent with the execution policy of the firm*".

Q7: Where an investment firm executes client orders by dealing on own account (including back-to-back trading), in light of the specificity of this execution model and since it is bound by the rules governing best execution, do you believe the current text is clear with regard to what kind of obligations investment firm applying such model should comply with? Or do you believe it would be useful to provide in the RTS list and explanations of information that should be included in the order execution policy, such as related to the method and steps to be taken by the firm to establish the price of client transactions in back-to-back trading, or the methodology for the firm's application of mark-ups or mark-downs in such order executions? Please also state the reasons for your answer.

AMAFI considers that it is sufficient to set out in the RTS the general principles for assessing best execution for transactions concluded on own account. Investment firms should be allowed to determine which mark-ups and mark-downs are appropriate for each client, each financial instrument and each transaction executed in specific market conditions.

Q8 : Are there any additional comments that you would like to raise and/or information that you would like to provide (for example, relevant information in relation to any expected costs and benefits arising from the proposals)?

Yes, AMAFI has the following additional comments:

- Scope
  - Of the RTS

For the sake of clarity[16], it should be specified that the scope of the RTS is limited to firms executing client orders and does not include firms receiving and transmitting orders or firms providing the investment service of portfolio management, for which it is not appropriate.

  - Of Articles 6 and 7

According to Article 6.1 of the RTS, the monitoring of execution quality aims to "*observe the effectiveness of [the] order execution arrangements and order execution policy*". Therefore, the scope of Article 6 should be limited to the execution venues included in the execution policy defined according to Article 3 and the Article should not aim at comparing execution prices with those obtained on other execution venues.

In contrast, under Article 7, which is dedicated to "*the assessment of the effectiveness of the order execution policy*", execution prices should be compared with a wider universe, including execution venues not included in the best execution policy.

[16] in accordance with Recital 2 of the RTS: "*For the service of reception and transmission of orders, Article 65 of Commission Delegated Regulation 2017/56510 applies, which includes establishing and implementing a policy to reach the best possible result for their clients in accordance with Article 27(1) of Directive 2014/65/EU. Investment firms offering such service should have policies and arrangements in place that ensure that the third parties the client orders are placed with or transmitted to, comply with the requirements in this Regulation. Investment firms providing the investment service reception and transmission of orders should also monitor and periodically assess the execution quality provided by these third parties and make amendments to the execution arrangements when deficiencies are identified.*"

- Disclosure to clients (*Article 3.2. (c)*)

AMAFI draws ESMA's attention to the fact that the name and capacity of the person or governance body of the investment firm that approved the selection of the execution venue is of no interest for potential investors and therefore should not be disclosed to clients. However, it makes perfect sense to include the same in the investment firm's internal policies.

- Order routing criteria (*Article 5*))

First of all, this Article, setting the rules to apply, upon receipt of a client order, for the selection of execution venues, falls outside ESMA's legal mandate and goes beyond the requirements set out at Level 1. As per the Lamfalussy principles, Level 2 legislation is meant to deal with the technical details of the rules set out at Level 1 but may not add to the latter without breaching the hierarchy of norms.

Moreover, we are unclear about the interpretation of Article 5 (2) f. If the aim is to require the assessment of the historical prices observed on the execution venues included in the investment firm's list in order to determine the execution venue to which a client order should be routed, it does not make sense: while such data must be taken into account at the stage of the monitoring of the execution quality, we struggle to see how it could be taken into account in the decision to route the order, as such a decision is primarily guided by the prices actually observed and not by historical prices. Given that time is of the essence, the time required to assess historical data is incompatible with the best execution criteria set out in Article 27(1) of MiFID, which includes speed. In the context of an inadequate requirement, the proportionality of the cost of its implementation (i.e. to retrieve, aggregate and assess data) is obviously unreasonable.

If this article is to be understood as a requirement to take into account historical data when selecting the execution venues to be included in the best execution policy, it duplicates Article 4.

AMAFI therefore suggests deleting Article 5(2)(f).

- Monitoring execution quality (*Article 6)*

In our view, this article is not being flexible enough to accommodate the various categories of financial instruments, for which market data or references do not always exist (in particular OTC bespoke financial instruments). In other words, it may not always be possible to set a threshold for such instruments and this practical reality should be better reflected in Article 6.

For example, the requirement to monitor execution quality at least every three months is not appropriate for non-liquid financial instruments for which transaction data may be very scarce. We therefore believe that the periodicity of the monitoring should be left to each firm, depending for e.g. on its activity and the categories of financial instruments in which it is active.

Moreover, paragraph *Article 6.2.(d)* stating that "*the monitoring procedure shall cover at least… the thresholds to monitor execution quality for each class of financial instruments, including an acceptable deviation of the execution results from the reference data and a percentage of minimum traded volume that must meet the threshold*" could be made clearer. Our understanding is that to assess the efficiency of their order execution arrangements and execution policy, firms should determine:

- A reference price data reflecting market conditions at the time of the execution;

- An acceptable deviation compared to such reference, expressed in percentage;
- A minimum percentage of transactions not exceeding the acceptable deviation (the threshold).

If our understanding is correct, *Article 6.2.(d)* could be drafted as follows:

> "~~***the thresholds***~~ *to monitor execution quality for each class of financial instruments,* ~~***including an acceptable deviation of the execution results from the reference data and a percentage of minimum traded volume that must meet the threshold***~~ ***the definition of :***
>
> - ***the reference data,***
> - ***the acceptable deviation to such reference data and***
> - ***the minimum percentage of transactions (the threshold) that should not fall outside this acceptable deviation.***"

Article 6.4 also seems to mix acceptable deviation and threshold. We therefore suggest the following drafting: "*For the purposes of calculating the percentage of minimum traded volume that meets the* ~~***threshold***~~ **acceptable deviation** *referred to in paragraph 2, point (d), the investment firm shall use data from a period of up to three months,…"*

- Assessment of the effectiveness of the order execution policy (*Article 7*)

Article 7.1 b) requires the assessment to be conducted "*whenever the execution quality of the monitored transactions during a monitoring period breaches a predefined threshold".* This requirement is too stringent and disproportionate considering the burden it entails to carry out such an assessment. We therefore suggest adding the term **"significantly"** to allow for some flexibility so as to avoid costly assessments in situations where they are not necessary and would be of no benefit to the clients.

- Client instruction (*Article 8.4)*

Paragraphs d)[17] and e)[18] should be merged into one single paragraph as they both relate to cases where clients rely on investment firms to obtain the best possible result.

- Dealing on own account when executing client orders (*Article 9*)

This article is unclear:

- Some requirements specifically relate to situations where the firm is acting "*on behalf of clients"* and therefore, as clarified under CESR's "Best execution under MiFID Q&A" (including *Commission answers to CESR scope issues under MiFID and the implementing Directive)*, owes best execution to its clients.

[17] under which clients are offered the possibility not to specify a specific execution venue, which means that the choice of the execution venue is the responsibility of the investment firm, including obtaining the best possible result for the execution of the order.

[18] under which the order will be routed in accordance with the investment firm's order execution policy if the client does not choose the execution venue.

- In contrast, § 3 seems to have a wider scope by referring to Article 64(4)[19] of the Commission Delegated Regulation (EU) 2017/565 applying not only to firms executing orders on behalf of clients but also to those "*taking decisions to deal in OTC products*".

However, this should be made clear in the text, as the chapeau, using the terms "*when executing client orders*", is confusing in that respect. In the same vein, Recital 19 should be amended so as not to involuntarily capture situations where best execution, as per the industry standard Four Fold Test[20], is not due.

In addition, Article 9 should contain two separate paragraphs:

- one applicable to situations where the investment firm is acting on behalf of clients, which should include paragraphs 1, 2 and 4;
- one applicable to all situations, which should only contain paragraph 3.

- Application date (*Article 10)*

The date of application should be sufficiently distant to allow market participants sufficient lead time to implement the new requirements.

In that respect, and while AMAFI strongly opposes the de facto mandatory use of the CT for the purpose of best execution requirements, firms who would choose to use the CT would face its unavailability until at least 2027.The operational implementation of the CT is indeed rather far in the future: the first tender process for shares and ETFs is due to be launched in January 2025 and the authorisation for OTC derivatives CTP is not expected until Q4 2026 or even Q1 2027. In this context, to allow firms who wish to use the CT to do so for the purpose of ensuring best execution, the RTS should not become applicable before the CT is available, bearing in mind that CTP authorisation does not mean immediate availability of CT data.

A timeframe similar to that of the CT should therefore be considered with regard to best execution, bearing in mind that CTP authorisation does not mean immediate availability of CT data.

[19] When executing orders or taking decision to deal in OTC products including bespoke products, the investment firm shall check the fairness of the price proposed to the client, by gathering market data used in the estimation of the price of such product and, where possible, by comparing with similar or comparable products.

[20] Stemming from Commission's answers to CESR scope issues under MiFID and the implementing Directive attached to CESR's Q&A on Best execution under MiFID