

BVI's¹ position on ESMA's Consultation Paper on Technical Standards specifying the criteria for establishing and assessing the effectiveness of investment firms' order execution policies

We welcome ESMA's work within the MiFID II review to further improve the effectiveness of the order execution policies provided by investment firms.

• **General Comments**

German fund management companies are already subject today to stringent best execution obligations as part of their business activities, which for collective asset management are governed by the German fund law and further specified in Section II of the BVI Code of Conduct.² For individual portfolio management, including outsourced fund management, it is governed by the MiFID II framework and the German Securities Trading Act ("WpHG"). Asset managers have already implemented extensive best execution requirements in order to obtain the best possible results for their clients when executing orders. This is a critical aspect of their fiduciary duty and is essential for maintaining client trust and regulatory compliance.

Asset managers consider within their best execution policy various factors such as price, costs, speed, likelihood of execution, settlement, size, and the nature of the orders. They continuously monitor and review their execution obligations, for instance through a transaction cost analysis (TCA). Asset managers provide transparency about their execution policies and report on the quality of execution. This includes publishing data on execution venues and the quality of execution obtained.

In Germany, the best execution obligations depend on the execution channels. If a portfolio manager informs the trading desk of the management company of a trading decision, the order will be executed directly against an exchange, MTF, OTF or against a counterparty acting as SI, market maker or other liquidity provider. In such cases the fund management company is obliged to ensure the best possible execution. The situation is different in cases of indirect execution. If the trading desk forwards the trading decision as an order to a broker for execution ("placement"), the fund management company is obliged to select the best possible broker. At the same time it must ensure that the selected brokers adhere to the best execution principles that enable the fund management company to fulfill its best execution obligations towards the investors/clients.

The selection of dealer/brokers by the German buy-side is based on a number of important criteria, for instance measures and controls to protect the companies' clients interests, financial stability and creditworthiness (check for liquidity and solvency risks), knowledge of the markets and the respective regulatory environment, quality and consistency in the execution of trading orders, access to liquidity sources and the ability to provide transaction cost analysis (TCA). The broker selection also considers the

¹ BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 116 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

² [BVI 5947 2019 Wohlverhaltensregeln 2018 engl Web V01.indd](#)



trading algorithms provided by this broker for the execution of trading orders. The German Buy-Side firms use only algorithms provided by the brokers. Asset managers do not use self-developed algorithms. Fund managers also do not use high-frequency trading strategies to execute as many transactions as possible for their own account in a very short period. Investment funds do not engage in transactions using high-frequency trading strategies that could jeopardize the stability and integrity of the financial markets or create harmful incentives for financial market participants. The venue selection of regulated markets (e.g. exchanges, MTFs, OTFs) relies in particular on the competitiveness of prices, liquidity and relative volatility of the market, speed and probability of execution, financial stability and creditworthiness of the execution venue and on the quality, costs and arrangements to support settlement and clearing.

As illustrated above, the German Buy-Side relies generally on the market infrastructure and the best execution provided by the Sell-Side.

According to our observation, ESMA's extended best execution proposals are designed more for Sell-Side firms (e.g. SIs, market maker and liquidity provider) than for the Buy-Side. Sell-Side firms and regulated markets are technologically more advanced and enabled to provide an effective and automated order execution policy as proposed by ESMA. Sell-Side-firms, however, have significantly invested in resources/equipment to provide the buy-side traders with a broad range of tools in order to comply with and monitor best execution.

We consider the proposed requirements as too prescriptive, granular, complex, costly and burdensome. The implementation could result in a major loss of flexibility on how asset managers trade products and how brokers are selected if all factors of the order execution policy (Article 3) and of the venue selection process per asset class (Article 4) are a prerequisite.

Adding an additional venue would not be easy to implement as it would take away any choice/flexibility for the Buy-Side traders to source the best liquidity. It should be possible to include multiple qualifying venues per asset class in best execution lists of execution venues. However, it would be too onerous to justify in advance the choice of one qualifying venue over another. Also Buy-Side firms cannot modify ex-ante within their best execution policy the venues which may provide the best price for the executed order if the venue is not mentioned in their existing list of brokers/regulated markets.

As the current best execution obligations provide sufficient and transparent analytical information to the (professional) client, we strongly fear that the proposed measures could be viewed as **best execution reporting tools** (cf. Article 6) without any additional benefit for the customers, thereby imposing disproportionate and unnecessary cost on the investment managers. In this respect, we remind ESMA/NCAs that the Buy-Side has expressed in the past their strong concerns about the effectiveness and value of RTS 28 reports. We have highlighted in the past that the reports often fail to provide meaningful and comparable data for fund managers and the public. Additionally, the efforts required to produce these reports was significant, yet they are rarely accessed or used.

Furthermore, it appears that ESMA's RTS proposal increases (and goes beyond) the regulatory obligations as defined in Article 27 (1) and Art 64 of the delegated regulation. By introducing the requirement to compare prices against a "consolidated dataset of reference prices" Art. 4 (1)(g), it appears that the RTS go beyond its intended scope and remit as defined in Art 27 (10).

In consideration with the EU Commission's aim to put a strong emphasis on enhancing the EU's competitiveness, we recommend taking a proportionate and practical approach to implement the best execution obligations. Therefore, we encourage ESMA/NCAs to ensure that the updated best execution



requirements are only to be implemented by Sell-Side-firms. Buy-Side firms should be exempted from such requirements as they use generally the services provided by the Sell-Side.

- **Specific Comments**

We would like to make the following specific comments:

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.

We tentatively agree in principle with the proposal to use the CFI code to classify financial instruments. Since 2002, BVI has advocated for automation in the financial market based on ISO standards, in particular the use of ISO identification numbers. BVI was instrumental in the EU's regulatory decision on the production of the OTC ISIN through the (newly) created ANNA-DSB in 2016 and for ensuring that the use of the identifier for reporting is offered in as cost effective a manner as possible.

However, we do not consider the proposed classification measures as a fit reporting tool for the (professional) client. We do not see how professional clients would take any benefit out of the ISO classification. The (professional) client would be completely at a loss when trying to verify the best execution policy in accordance with ISO identifiers.

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.

We consider the proposed requirements as too prescriptive, granular, complex and burdensome to be implemented. The implementation could result in a major loss of flexibility on how asset managers can trade, especially in the area of fixed income products if the venue selection process is a prerequisite. Adding an additional venue would not be easy to implement as it would take away any choice/flexibility for the Buy-Side traders to source the best liquidity. It should be possible to include multiple qualifying venues per asset class in best execution list of execution venues. However, it would be too onerous to justify in advance the choice of one venue over another.

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?

We strongly disagree with the proposal to use the consolidated ticker (CT) data as a monitoring tool for best execution (Article 4 (1) (g) (i) in combination with (2)). The EU Buy-Side has been actively involved in discussions about the CT for European capital markets. We welcome the idea of a CT, which aims to provide a comprehensive and standardized view of European trading data. However, we had strongly advocated that while contributions to the CT should be mandatory for trading venues and the relevant market data contributors, the use of CT data should remain voluntary. We have concerns about the costs associated with accessing CT data and believe that the price should be based on the cost of data



production and dissemination as well as a reasonable margin to avoid prohibitive costs for market participants. Furthermore, some firms will source direct feeds due to the need for lower-latency data, and hence would have no need for the CT for this purpose.

As ESMA's proposal considers the use of "*alternative datasets, provided the alternative dataset provides at least the same reference data quality as the consolidated tape data*" (Article 4 (2)), we strongly fear that the selection/usage of alternative datasets could be of restricted as in practice the data users will have to buy also the data set provided by the CT, in order to be able to test and demonstrate the comparable quality of the alternative and the CTP provided price feeds, thereby harming the free choice of provider by the buy-side.

Furthermore, this requirement introduced at RTS level redefines the Best Execution Criteria outlined in Article 27 (1) , Article 64 and Article 66 of the delegated regulation, which do not refer to external/ alternative price reference data / consolidated tape data but only to factors of relative importance which include the characteristics of the client, the client order, the financial instrument and the characteristics of the available execution venues where the order can be directed.

Therefore, we suggest the following wordings:

- **Article 4(1) (g)**

(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;

- **Article 4 (2)**

*2. For the purpose of taking into account the criterion of price in accordance with paragraph 1, point (g), an investment firm ~~may~~ **shall** use ~~the consolidated tape data or alternative datasets~~ **provided by the relevant market data providers**, ~~provided the alternative dataset provides at least the same reference data quality as the consolidated tape data.~~*

- **Article 6 (5) (a) and (b)**

5. For the purposes of the monitoring procedure referred to in paragraph 1, an investment firm shall use reference dataset based on:

*(a) **a dataset provided by the relevant market data providers or** consolidated tape data;*

(b) ~~alternative data sources, where consolidated tape data is not available or where the firm is able to demonstrate that an alternative dataset provides at least the same reference data quality;~~

~~e)~~for classes of instruments which are executed over the counter, including bespoke products, data provided by third parties, provided the investment firm has valuation systems in place to ensure systematic and robust checks of the fair price of such classes of instruments.

- **Article 7 (2) (a)**

The assessments referred to in paragraph 1 shall assess at least the following factors:



(a) the price of execution compared to a reference dataset ~~based on consolidated tape data or, where such data is unavailable or where an alternative dataset provides at least the same reference data quality, alternative reference datasets;~~

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 the current best execution obligations provide sufficient and transparent analytical information to the (professional) client, we strongly fear that the proposed measures could be viewed as a **best execution reporting tool** (cf. Article 6) without any additional benefit for the customers, thereby imposing disproportionate and unnecessary cost for the investment managers. We believe that verifying the best execution obligations only on a transaction cost basis is too restrictive. There are any further aspects which should be taken into consideration such as size, liquidity, speed and market impact.

In respect to Article 6 (2) we strongly object the following measures:

- *(a) the periodicity of the monitoring, which shall be at least once every three months*

The time span to verify the best execution policy by at least every three months is too short and not aligned with a risk based approach. This would likely result in too small samples and anomalies due to significant market events. Normally, Buy-Side firms verify their best execution policy once per year.

- *(c) an assessment of all transactions of the investment firm, or a representative sample, for each class of financial instruments;*
- *(d) 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.*

A review of all transactions is quite burdensome and complex without any additional value for the professional client.

In respect to Article 7 (1): Point (b) should be deleted.

As execution factors may vary depending on the relative importance of a financial instrument, the client and the execution venue, defining thresholds will be impossible in nature without providing a benefit to retail or institutional clients. Furthermore, this additional requirement exceeds the obligations defined in Art 65 (7) which require firms to assess if a material change has occurred and whether such changes trigger any changes to the venue selection.

The definition what constitutes a "material change" defined in Art. 65 (7) (3) is already sufficiently clear and does not need to be enhanced (and should not be redefined) via an RTS change.

In respect to Article 7 (2):

2. The assessments referred to in paragraph 1 shall assess at least the following factors:



~~(a) the price of execution compared to a reference dataset based on consolidated tape data or, where such data is unavailable or where an alternative market dataset provides at least the same reference data quality, alternative reference datasets;~~

(b) the following costs and fees charged to the investment firm:

- (i) trading and order execution fees;
- (ii) cost of membership or connectivity;
- (iii) costs and charges for clearing, settlement, custody and other administration services related to the choice of execution venue;

(c) the speed of execution;

~~(d) the functioning of its internal order execution arrangements and its impact on the obtained execution quality on the selected execution venues;~~

~~(e) market developments concerning execution venues and the impact on the firm's ability to obtain, for its client orders, the best possible result on a consistent basis;~~

~~(f) the emergence of new execution venues~~

Criteria (a), (d), (e) and (f) are new and it is unclear how adding additional factors and considerations shall provide more clarity for retail and professional clients regarding the overall execution in the best interest of the client.

As described above, reference to consolidated data sets are unlikely to provide sufficient clarity if orders have been executed in the best interest of the client as it does not consider the likelihood of execution and settlement factors.

To reference and specifically differentiate the "functioning of internal order execution arrangements" for all different asset classes is a new concept which leads to further administrative burden without creating more transparency. This is not an execution factor "per se" but rather an aspect which is already covered with the speed of execution and likelihood of execution/ settlement. Requesting a separate assessment on this aspect will overlap with (and impair) the analysis of the likelihood of settlement and speed of execution.

Assessments in "market developments" and "emergence of new execution venues" are at the core of the day to day activities of brokers. Such an assessment in the context of an Execution Policy is unlikely to be fact/ transaction data based but rather hypothetical and theoretical in nature. This is unlikely to improve the content of the Order Execution Policy but more likely be a formality without providing conclusive results for 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.

We have no comments.

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.

We have no comments.

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.

We have no comments.

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)?

We have no comments.
