FESE response to the ESMA consultation on technical standards specifying the criteria for establishing and assessing the effectiveness of investment firms' order execution policies

16th October 2024, Brussels

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.

FESE would agree that investment firms shall distinguish between not only different classes of instruments but also between countries of primary listings for shares and we understand that this approach is already taken by many firms. In particular for retail investors, it is important that investment firms consider different trading venues depending on the liquidity available on each platform and the prices, among other criteria. While we cannot recommend a specific categorisation over another, we believe it is important that they are consistent across investment firms to allow clients easy comparisons.

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.

FESE generally agrees with the proposal to require firms to include in their execution policies at least the execution venue(s) that enable them to consistently obtain the best possible result for the execution of client orders, per class of financial instrument, order type, category of clients, and information about the internal approval of the venue through firms' governance procedures.

We would however point out that best execution policies defined by investment firms should in general include more than one possible execution venue. Regulation should aim at a level playing field between execution venues and support a healthy mix of order flows to allow for an efficient price formation process and ensure investor protection. As an example, the ban on payment for order flow (PFOF) contributes to these objectives, by avoiding the segmentation of the retail and institutional flow. Similarly, best execution policies also play a role in allowing for different types of flow to interact together thereby promoting price efficiency and a level playing field between execution venues. Retail investors are particularly of concern here and we agree with the proposal included in Article 4 and Article 5, where ESMA distinguishes between retail and professional clients.

Hence we believe that single-execution venue policies should only be possible under clear rules and according to simple and observable objective criteria. For instruments or classes of instruments only traded on one venue, like some derivatives, the best execution policy would include only the relevant venue; it can also be the case that the market share for the relevant instrument is high enough to justify along with other criteria that only the most liquid venue is selected. FESE also recommends that any kind of exclusive agreement between an investment firm and an execution venue shall be mentioned in the best execution policy of the investment firm to ensure full transparency to their clients.

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?

FESE suggests that execution criteria should be distinct depending on the order type: market orders vs. Limit order, highlighting the precise criteria used for each order types, how they are assessed, monitored and hence the specific execution policies for each order type. In particular, for each order types, these criteria should include a clear description of the measure of market impact.

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.

FESE generally agrees with the proposals and the aim to obtain the best possible result for the clients of investment firms such as requiring investment firms to distinguish the fees related to the order execution from those charged to the firm or assessing all transactions per class of instrument or a representative sample of them. However, we would like to add the following comments:

- The methodology applied to execution policy monitoring should take place at least once every three months, especially in the case of policies with a single execution venue;
- Assessment of the best execution policy shall, whenever possible, include a reference to the number of trading venues where the relevant instrument is listed allowing for comparison;
- We would also recommend adding the market share in the financial instrument for the individual venue in comparison to the whole EU market as a key indicator, as it is a proxy for the order book quality (price level and depth) available on each venue. This indicator should always be taken into account by investment firms defining or revising their best execution policies. When the trading venue with the highest liquidity remains out of the scope of the venues selected by the intermediary, the intermediary should be required to justify this absence;
- Regarding the thresholds to monitor execution policy, ensure that thresholds and deviation of the execution results are not set at levels low enough to guarantee that the policy is in practice rarely reviewed or modified;
- There is also a need to add additional criteria to be assessed about information leakage prevention and how the firm monitors and manages mark-ups;
- Regarding the inclusion of a comparison of the prices obtained for client orders with a reference dataset based on CT data, we would like to make clear that CT data should not be considered ex-ante for best execution purposes, nor order routing given the latency issues it presents. in the EU and as discussed during the political process in the context of L1. Furthermore, for the CTP to provide the data quality needed to become an integral part of trading, it will be of essence that any pending data quality issues (such as correct flaggings and correct reporting, provision of correct and sufficiently granular time stamps) will be solved to start with. This may be a question of time and readiness of all affected parties alike, and hence, ESMA should take this into account

here as well. Those issues should be addressed first before requiring the use of the CT as the reference for defining, but especially for monitoring and assessing best execution. In particular, there is a need to have certainty that the CT will receive appropriately flagged data and correctly timestamped for inbound and outbound feeds before linking it in such a way. Taking this into account we would recommend that ESMA softens its references to the CT in Articles 4,6 and 7.

Therefore, we recommend that ESMA wait for the proper definition of RTS 1 and CT input/output data RTS, and then could potentially issue guidelines that supplement the best execution requirements which could specifically provide for the use of the CT in the context of best execution definition, assessment and monitoring.

We finally would like to specifically highlight that the CT was never meant to be a mandatory requirement for brokers/data users.

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.

FESE believes it is important that benchmarks used for best execution purposes must be presented with sufficient levels of granularity to clients, i.e. the investment firms selecting a benchmark shall explain the rationale for this choice, the advantages and limits of the methodology used by the benchmark, its corporate / ownership structure and any potential conflicts of interests.

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.

In the case of retail investors, it should be noted that the order screen is decisive for the client. The way the execution venues are presented on screen, especially the one at the top, would have a much higher probability of selection even if they do not offer the best outcome. The number of venues shown on screen is also important, where venues not immediately visible have a lower chance of selection. FESE believes that retail investors should make informed decisions based on clear and transparent comparisons between execution venues. Investment firms should therefore be as transparent as possible and provide retail investors with the clearest picture regarding costs for each trading venue, potential exclusivity agreements between the investment firm and the execution venue, etc.

Furthermore, we would question the case of clients' instructions producing de facto policies with a single execution venue, which as explained in our response to Q2 results in segmentation of the order flow. Indeed, by declaring each order as one for which the client has given an instruction, brokers are exempt from best execution requirements under MiFID II which ends up in a single execution venue policy. FESE believes that the current review of best execution policies should ensure consistency and avoid the exception becoming a custom practice. Thus, for financial instruments that are traded in multiple venues (notably for equity markets), FESE proposes that client instructions should only be possible if the broker offers several execution venues to choose from. This should not apply to derivatives products, which are in most cases trading venue-specific.

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.

FESE suggests that Article 9(1)(b) should be complemented with additional text stating that dealing on own account against client orders should only be allowed when there is significant improvement in the quality of execution of the order versus the quality of execution provided by trading venues.

It is critical to add that in this situation, the investment firm should have a clear and transparent methodology to assess information leakage and markups, by providing a factual comparison of the quality of execution received (i) at the time against the own account of the firm vs. what was available at the very same time on competing venues and (ii) also providing a view of how markets have evolved xx seconds after the execution of the order (as a proxy for implicit costs). This assessment should be part of the execution policy review.

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 about any expected costs and benefits arising from the proposals)?

In an increasingly fragmented trading environment, clients need to have much more understandable, factual and granular information on best execution policies and outcomes when it comes to the quality of execution of their individual orders. To this end, investment firms should be required to better detail the ex-ante rationale of their order execution policies across various order types and to provide clients with sufficiently granular means to assess the quality of execution effectively received for each executed order.

In addition, FESE has the following specific comments:

- Article 5(2)(d) is critical. This relates to the criteria that must be taken into account in the firm's order routing criteria and specifically refers to **real-time market data concerning the financial instrument**, including the relevant prices offered by available execution venues and the likelihood of execution at the available execution venues at the intended execution time. It is essential this is maintained to avoid having the CT used as a source for routing purposes, with its distortive effects on execution quality outcomes due to geographical dispersion.
- Article 5(2)(f)(ii) requires **historical data including volumes of transactions executed** to be considered in the firm's order routing criteria. FESE would also recommend looking at market quality and the order book depth in the financial instrument for the individual venue in comparison to the whole EU market as a key indicator, as it is a proxy for the liquidity available in each venue. This indicator should always be taken into account by investment firms defining or revising their best execution policies. When the venue with the highest liquidity remains out of the scope of the venues selected by the intermediary, the intermediary should be required to justify this absence
- **Regarding the speed of execution** (as referred to in Articles 5, 6, 7), FESE believes that this should be measured by calculating the time period between the moment an order enters the trading system and the moment it is executed. This indicator should only be used for aggressive orders for which speed of execution is obviously a key goal, whilst passive orders respond to very different trading strategies and needs.