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**AFG'S RESPONSE TO ESMA'S  
CONSULTATION**

# **Technical Standards specifying the criteria for establishing and assessing the effectiveness of investment firms' order execution policies**



**AFG**



The AFG federates the asset management industry for 60 years, serving investors and the economy. It is the collective voice of its members, the asset management companies, whether they are entrepreneurs or subsidiaries of banking or insurance groups, French or foreigners. In France, the asset management industry comprises 700 management companies, with €4600 billion under management and 102,000 jobs, including 27,000 jobs in management companies.

The AFG commits to the growth of the asset management industry, brings out solutions that benefit all players in its ecosystem and makes the industry shine and develop in France, Europe and beyond, in the interests of all. The AFG is fully invested to the future.

We thank ESMA for this consultation.

Discussions with our members gathered feed-back that a standardized and simple policy guidance will serve clients' interests and be a building block of the industry reputation, offering common standards to back current satisfactory and already detailed execution policies established by each entity.

By nature and purpose the policy has to be descriptive and is not meant to deliver analytical results. It is insofar different from a reporting obligation and in no way a future RTS should transform obligation of transparency on execution policies into a RTS 28 reporting requirement.

We furthermore are not aware of any issue from retail (or institutional) investors justifying the need to adopt such far going requirements as set out under the draft proposal. We believe that they would handicap policies meaningfulness rather than foster it. Besides, unnecessary complexity is detrimental to retail investor good understanding basis of good protection.

With a strong focus on "best price", such proposal is not tailored for price driven markets.

Proper guidance for best execution should not aim at encompassing all aspects and details of trading. Venue and counterpart selection, for instance, is also strongly connected to the investment firm risk management.

Accuracy of a policy depends on its adequacy. Impact assessment is a necessary prelude.

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 do agree that harmonised categorisation can be useful.

We disagree with ESMA's proposal to use the ISO 10962 Standard on the classification of financial instruments for the categorisation as part of the order execution policy.

This would mean having to differentiate between 76 different categories and, for the groups within equities category, between each country of primary listing. Such a granular categorisation is extremely burdensome to set for firms and has no added value/benefit for end investors. It doesn't allow them to understand and comprehend the various policies, which is contrary to the core objective of an order execution policy.

We think that the complexity of the ISO standard 10962 does not match the call of Authorities for policies that can be easily understood by institutional and retail clients. In addition, it increases the risk of allocation & reporting error.

The aim is to offer an umbrella policy fitting existing categorization, suitable for equity but also other asset classes such as fixed income instruments and easily readable by institutional and retail investors.

For the sake of consistency, as an alternative, the existing classification of financial instruments in MiFID II already applied RTS such as RTS 1 / 2 should be used. It would provide homogeneity between classifications while leaving more flexibility for firms.

Besides, the consultation offers that firms can cluster several classes. Asset managers will naturally add specificities to their policies when needed (ex: complex/structured assets). If they do so, then RTS could invite to optionally use ISO 10962.

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.

Current wording is clear and sufficient.

It is in the clients' interest that venue selection be part of best execution, based on a clear set of qualitative and quantitative criteria applicable to all investment firms and totally accessible to clients.

These criteria will be building blocks of a list of selected venues. A venue can appear as eligible for some assets and clients, while ineligible for others. And it eventually can appear that the investment firm selects only one venue to execute all client orders. The selection process should not differ, to back the validation of a single or multiple venues: this is key in validating the possible conclusion that only one execution venue is the best choice.

This eligibility list can be amended from time to time. Referring to a single list of criteria is more robust to do so.

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 do not agree.

It is crucial that the order size be considered in light of the characteristics of the market segment in which it is executed. Taking into account order size is all the more important in price-taker markets.

Execution policy depends on and has to take into account an order size, but also other criteria such as average order size, client type, asset class, bloc trading / portfolio trading / program trade or not, liquidity, frequency, pricing power, granularity/standardization...).

Those are not alternative but complementary elements to choose the right venue. The added value of experienced traders, obeying clear and demanding internal process but also knowing their market specificities (notably how to build/elaborate a pricing on each asset), their counterparties and participant superior expertise on specific instruments, are obviously decisive to have execution perfectly customized to each case. Excessive guidance on how to conduct their diligence is counter-productive.

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.

We do not agree.

MiFID II is already introducing under Art. 27 a series of stringent requirements in regards to firm’s execution policies.

In addition, investment firms are very serious – in their own and clients’ interests – about reviewing their order policies to insert updates or necessary adjustments.

As described in the policies, compliance officers are actively involved and constantly watching. Internal controls are numerous.

Some asset managers have set up analytical tools demonstrating how their execution process offers better prices on ongoing basis.

So best execution is being permanently scrutinized and audited, qualitatively and quantitatively..The price, compared to relevant average market price, is one important criteria for establishing and assessing the effectiveness of execution policy, but this (or a similar threshold) taken alone is superficial and insufficient.

Market participant quality, speed and likelihood of execution – liquidity !-, settlement and fees are definitely part of a sound best execution equation.

Historical price re-discovery is a faulse cognate, difficult to well build and potentially misleading (we wish, past prices were indicative of current ones...).

Cost-benefit analysis will knock down this idea.

Consolidated Tape (CT) is not panacea for this data collection. It is useful but is not flawless. CT should not become compulsory nor be qualified as preferred source: it is one source of data amongst others and alternative sound datasets must be put on an equal footing. Also, beware of creating potential data supply monopolies, here; there are pros and cons about unicity of CTP.



We don't know yet the quality of the CTs to be created and if they will provide reliable data, on a reasonable cost basis and the data will be swiftly available.

CT can deliver redundant information associated to disproportionate cost for asset managers relying already on alternative data sources and data providers.. Any requirement to prove that an alternative dataset to the CT presents the same data quality is misplaced and should be deleted.

Lastly, MiFIR level 1 does not provide for a mandatory use of CT. Consequently Level 2 regulation cannot go beyond.

We believe that an annual assessment of the execution policy effectiveness is optimal, in that it induces a reasonably long period to draw well-built conclusions based on representative data samples. Such a frequency also avoids too frequent time-consuming works. Investment firms are willing to perform more frequent analysis where the volume and/or seasonality of their transactions would require it.

So we disagree with a 3month compulsory assessment period.

Automated order routing systems are internally validated and audited. Their existence and use may be described in policies.

**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 agree that monitoring and assessment can be performed by independent\* third parties.

(\*These providers should hence not be payed by the investment firms.)

In the sake of objectivity, we also recommend that the monitoring and assessment process be unique and similar for all investment firms, obeying guidance from ESMA.

An undisputable record of prices at the moment of execution is a must. But historical data analysis will not fairly support good (or bad) execution.

**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.**

It should be possible to pre-select, always as a specific instruction.

The choice of the execution venue is a key parameter of best execution policy at a given time. The constraint of this choice due to a client instruction – even though it results in selecting the same venue than the one freely chosen by the investment firm at a given time - has to be flagged. It does constitute a specific instruction of which the consequences will and must be assumed by the instructing client.

**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.

This question is generally out of asset managers' scope.

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 are confident that internal rules of order execution policies offer a fair and sound protection of asset managers' client interest.

We hope that ESMA rules will offer a strong balance of fair regulation and enlightened defence of the European industry competitiveness, in alignment with the European Commission mandate.

Overcomplexity is costly and this is detrimental to the attractiveness of what can be offered to the investors.

Resuming what should to our understanding guide the setting of the RTS:

- Criteria must be meaningful for targeted addressees of the policy. Requiring an unreasonable level of granular information which generates high cost of production whilst not delivering useful results must be avoided
- A sound cost benefit analysis should be conducted as EU competitiveness is at stake
- The policy is a generic document dedicated to a large scope of (potential) investors
- It shall sufficiently explain the methodology of order execution for different classes of financial instruments and give examples of theoretical circumstances under which derogations would apply or policy would be changed but not take all possible specific cases into account
- It shall define a reasonable frequency for assessment and monitoring obligations but not require to publish within the policy document analytical results (MIFID II requires a whole set of reportings which already fulfill this aim)
- Categorization of classes of financial instruments within the scope of the policy shall be standardized so that existing and future clients can compare order policies of different service providers.
- Level 2 legislation should not introduce de facto obligations not mandated in Level 1 (i.e. mandatory use of CT dataset)

We are looking forward to the output of this consultation and will be happy to further contribute and share the French asset managers' viewpoints





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tomorrow together