ICMA response to the ESMA Consultation Paper :

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

16 October, 2024

Introduction:

ICMA welcomes the opportunity to respond to the ESMA MiFID II Review Consultation Paper on the Technical Standards specifying the criteria for establishing and assessing the effectiveness of investment firms' order execution policies.

ICMA promotes well-functioning cross-border capital markets, which are essential to fund sustainable economic growth. It is a not-for-profit membership association with offices in Zurich, London, Paris, Brussels and Hong Kong, serving over 620 member firms in nearly 70 jurisdictions globally. Its members include private and public sector issuers, banks and securities dealers, asset and fund managers, insurance companies, law firms, capital market infrastructure providers and central banks. ICMA provides industry-driven standards and recommendations, prioritising three core fixed income market areas: primary, secondary and repo and collateral, with cross-cutting themes of sustainable finance and FinTech and digitalisation. ICMA works with regulatory and governmental authorities, helping to ensure that financial regulation supports stable and efficient capital markets.

Executive summary:

In general, and as highlighted in our response under Question 8, ICMA members are of the view that a lot of additional details have been proposed as requirements under the new RTS, of which the purpose is not clear to members.

ESMA's proposals in this CP generally appear to be targeted towards retail investors and may not be appropriate for wholesale investors, who have a different understanding of the market and may not need the same level of protections / disclosures as retail clients. We are concerned that as a result, some of the proposals may not be appropriate or beneficial for wholesale investors and could in fact make order execution policies more complicated and difficult to read.

Further details can be found in our responses on Questions 1-8.

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.

ICMA response:

ICMA members would appreciate greater clarity from ESMA about the issues that ESMA or NCAs have observed regarding how order execution policies are currently structured (which is by line of business) and that the proposals therefore are seeking to address.

With respect to the proposed categorisation of classes of financial instruments, it is in general not clear to members what meaningful benefit would be gained from introducing such detailed classification requirements and levels of granularity. For example, members do not believe that a detailed classification down to the second letter of the CFI code will add any additional benefits to clients and may in practice lead to order execution policies looking more complex and difficult for clients to understand. At the same time, we anticipate that these classification rules would create a significant administrative burden to investment firms to perform a mapping exercise between their list of execution venues and the proposed classification model. The reason for this proposal is therefore not clear to members.

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.

ICMA response:

From a sell-side firm perspective and in regard to ESMA's proposals in this section under paragraphs 23-25 of this CP, it is important to clarify to ESMA that sell-side firms in the context of OTC bond transactions usually act as the execution venue for buy-side clients and as such would not be responsible for selecting an execution venue on their side. When executing such OTC transactions, sell-side firms would usually as a first step be responding to buy-side client RFQs either directly (via telephone, messaging systems, etc) or via trading venues, and the client would then either select the trading venue to execute the transaction with the sell-side firm, or trade directly with the sell-side firm.

From a buy-side perspective members do not think it is necessary to disclose at granular level the selected venues per class of financial instrument as it leads to a framework that is too restrictive and does not allow for a quick pivot as market conditions change. Members hold a strong view that existing best execution policies are sufficient in including venue selection based on quantitative and qualitative criteria and are flexible enough for investment firms to adapt as and when they need. It should not matter if an investment firm chooses to elect one or multiple venues for a financial instrument as either way, it has gone through the validation

process under the existing framework and therefore we think that referring to the same list of criteria for single or multiple venues is more appropriate.

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?

ICMA response:

With respect to the proposal to use order values that are representative of clients' orders when selecting eligible execution venues, members are of the view that this would not be an appropriate metric, given that orders are often aggregated by firms. Members therefore believe that Article 4 (1) (d) (i) and (ii) of the draft RTS as mentioned on page 22/23 of the CP (and as outlined below (in blue)) are not needed.

> Article 4 (1)
> "(d) the typical frequency and value of orders from its clients, including:
> (i) for retail clients, at least two different order frequencies and values that are representative of the orders from the retail clients of the investment firm;
> (ii) for professional clients, at least two different order frequencies and values that are representative of the professional clients of the investment firm, including, where applicable, the order size in relation to the average daily volume of the financial instrument;"

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.

ICMA response:

With respect to ESMA's proposals in relation to the Consolidated Tape (CT) for Bonds under this section, we would like to highlight first of all that ICMA members are supportive of the introduction of a consolidated tape for bonds in the EU. ICMA members recognise that the CT will be subject to direct authorisation, supervision and enforcement by ESMA and bound to high data quality provisions as per MiFIR Article 22 (b) and that as such, the CT should be in a position to be a key means to monitor and assess execution quality. However, members do not agree with the proposal under paragraph 32 of the CP and Recital (11) of the draft RTS which states "*Once and where available, the data provided by the consolidated tapes will be valuable and the preferred source for assessing the quality of execution*". ICMA members furthermore do not agree with draft RTS Articles 4 (2) which states that "*For the purpose of taking into account the criterion of price in accordance with paragraph 1, point (g), an investment firm shall use the consolidated tape data or alternative datasets, provided the alternative dataset provides at least the same reference data quality as the consolidated tape data*." , and also draft Article 6 (5)(a)

and (b), stating that "*For the purposes of the monitoring procedure referred to in paragraph 1, an investment firm shall use a reference dataset based on: (a) 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*;" and draft Article 7(2) (a) which states that: "*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*;"

All of these above mentioned wordings imply that the use of the Consolidated Tape should be mandatory for firms, which is against previous discussions and in conflict with Recital (8) of the revised MIFID II (Directive (EU) 2024/790) which states that: "*The data that the consolidated tape is expected to disseminate are the European best bid and offer, post-trade information regarding transactions in shares and exchange-traded funds (ETFs) and post-trade information regarding transactions in bonds and over-the-counter (OTC) derivatives*. ***That information can be used for proving best execution***." The level 1 text clearly does not introduce the obligation to consume the consolidated tape data.

ICMA members therefore would like to ask that all of the above mentioned wordings of the draft RTS under this CP will be amended to clarify that the use of the consolidated tape will be optional, not mandatory, that the consolidated tape is not a preferred data set, and that firms can use alternative data sets if they wish to do so, regardless of whether a consolidated tape exists. Furthermore, ICMA members would like to point out that investment firms typically achieve execution across a variety of trading venues, to account for the extremely fragmented and multilateral trading architecture of EU markets and that in addition to price, other variables such as for example transaction volume, execution certainty, and costs of settlement & clearing that are not in scope of the EU consolidated tape also need to be taken into consideration in the context of best execution.

On this basis, ICMA suggests the following amendments:

- Delete Recital (11): 'Once and where available, the data provided by the consolidated tapes will be valuable and the preferred source for assessing the quality of execution'.
- Delete the last part of the sentence of 4 (2) so that the following wording remains: *"For the purpose of taking into account the criterion of price in accordance with paragraph 1, point (g), an investment firm shall use the consolidated tape data or alternative datasets."* and apply the same wording to Article 6 (5). We have proposed removing reference to the alternative data set having to provide 'at least the same reference data quality' as it would create a high burden of proof for firms to be able to demonstrate that an alternative data set provides the same reference data quality as the consolidated tape.

Whereas members were happy with the optional use of Consolidated Tape (CT) data for the purpose of monitoring of execution quality as referred to under Article 6, concerns were raised with respect to the CT data being also used for the assessment of the effectiveness of the order execution policy as mentioned under Article 7 (2) (a) of the draft RTS and would ask for the wording here to be deleted.

With respect to the timing of three months to update order execution policies and order execution arrangements and correct any deficiencies following a review of order execution

policies and order execution arrangements as proposed in paragraph 31 and draft RTS Article 7 (6) of this CP, ICMA members consider this period far too short to make any amendments as firms will need a longer period of time to go through internal governance procedures before making amendments. ICMA members would like to propose a period of 6-12 months instead.

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.

ICMA response:

ICMA agrees that Investment Firms should be able to rely on an independent third-party provider, should they wish to do so. It is likely already done by firms today for example for TCA analysis.

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.

ICMA response:

ICMA members would think that it is difficult to implement the pre-selection of an execution venue in the order screen, where the firm invites its clients to choose an executing venue out of multiple options. This does not seem practicable. Client orders are already specified as per IMA with best execution.

Furthermore, ICMA members do not agree with the proposal under paragraph 38 (ii) of the CP and associated draft RTS article 8 (4) (c) which says : "(ii) that a warning will be provided to the client immediately prior to placing an order that the selection of an execution venue by the client may prevent the investment firm from obtaining the best possible result for the execution of the order;"

This requirement would be difficult to apply in practice as it is not clear how such warning should be issued to clients on short notice when in the process of executing an order. Furthermore, this requirement might cause delays in executing the client order, if firms would have to wait for explicit client approval to proceed, which might lead to a poorer outcome for clients. Alternatively, if firms are required to simply issue a warning to the client but are able to execute without having to wait on the client to confirm that they consent, then this would appear to not deliver any meaningful benefit if the client is unable to change their order in light of the warning.

In any case, ICMA disagrees with the requirement for firms to issue such warning on an order-by-order basis and such warning should only have to be included as a broad disclosure in a firm's order execution policy (as is the case currently). In ICMA members' view, it was not clear in the consultation why the current method of disclosure is not sufficient.

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.

ICMA response:

ICMA does not think it would be useful to provide in the RTS a list and explanations.

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)?

ICMA response:

In general, ICMA members are of the view that a lot of additional details have been proposed as requirements under the new RTS, of which the purpose is not clear to members, as per our responses to the questions above.

ESMA's proposals in this CP generally appear to be targeted towards retail investors and may not be appropriate for wholesale investors, who have a different understanding of the market and may not need the same level of protections / disclosures as retail clients. We are concerned that as a result, some of the proposals may not be appropriate or beneficial for wholesale investors and could in fact make order execution policies more complicated and difficult to read.

Furthermore, ICMA members would welcome ESMA guidance in respect of the implementation period of this RTS, given that the amendments under MIFID II have to be transposed into national law within 18 months, until 29 September 2025. A timeline and guidance on transitional period would be very helpful and from ICMA's perspective it would make sense for this RTS starting not earlier than this date.
