

Paul Richards  
Business Standards Department  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London  
E14 5HS

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Dear Paul

## **Best Execution - CP154**

I am responding on behalf of the Consumer Panel to CP154.

In general, we support the proposals to restructure best execution and to put the emphasis on achieving the 'best result' for a firm's customer, whether retail or institutional. We are, however, more concerned with best execution for retail consumers. The consultation paper puts considerable emphasis on the effects of competition between execution venues in achieving best execution. However, we are not convinced that consumers understand enough about the issues to make informed choices, and if they do not do so, then it is hard to see how competition will develop in the retail sector. The paper itself points out that most private customers tend to judge the quality of a firm's trade execution services by the immediacy of execution and the price and not by any of the more complex matters proposed for inclusion in assessment of best execution. We would be interested to know what evidence there is of shopping around by retail customers, even on the limited price point.

The provisions relating to obligations on firms to review execution arrangements and monitor execution quality appear to acknowledge the need for consumer protection standards, rather than simply relying on consumers to make informed choices to drive competition, and we welcome this. We would also welcome knowing what role the regulator will take in ensuring the regulatory requirements are met. Much of the discussion centres round the difficulty in anyone assessing whether a best execution requirement has been met; for example, in paragraph 3.35, you point out the difficulty of assessing whether a timely execution has been made. While we recognise that it may be necessary to rely on the 'proper exercise in judgement of firms', it is not clear whether any systematic failure to exercise judgement will be detected either by the regulator or by a retail consumer.

The paper removes any certainties that exist, such as price benchmarks and a requirement for access to a minimum number of venues. While we understand the reasons for doing so, we think there is a need to develop, at least for retail consumers, some simple kind of tool for comparing execution arrangements. This might be part of the comparative tables, but we also think that the FSA should

consider prescribing the format of what consumers are told about execution arrangements under paragraphs 4.5-9. If consumers were alerted to information which may vary between firms, they might more easily be educated to looking out for the firm that served their needs best.

Finally, as far as our more general comments are concerned, we are confused about the question of bundled services and soft commission arrangements in the paper. Paragraph 3.27 says that it is to be the subject of a separate discussion paper. But paragraph 4.8 implies that such arrangements will continue to exist and the only protection consumers will get is through disclosure. The paper recognises that such arrangements involve conflicts of interest and may disadvantage some consumers disproportionately to others. Consumers should not be left to protect themselves by close attention to the detail of disclosure documents from the potential adverse consequences of firms deciding conflicts in their own favour. There should be a regulatory mechanism.

**Q1 Do you agree that both the explicit and implicit costs discussed above (on pages 13-14 of the CP) are those relevant to best execution? Are there any other costs that should be included?**

We agree that the best execution framework should not focus solely on price. From the consumer perspective, any trading costs that incurred are also relevant in the context of determining that 'best execution' has been achieved. It is important that consumers are presented with the complete picture. Firms will be better placed than we are to advise on whether the CP captures all explicit and implicit costs.

We agree that, where explicit or direct costs are not passed on to the customer, they should be excluded from the assessment of best execution.

We also agree that a distinction should be made between trading costs and a firm's own charges on the grounds that the charges levied by the firm to the customer for its services (e.g. transaction charges or investment management fees) are known in advance and agreed separately by the customer.

**Q2 Do you agree that costs should encompass commission-related activities in the way outlined above (on page 15 of the CP)?**

We look forward to further discussions on the market research that the FSA has commissioned on the provision of 'bundled' services and soft commission arrangements. We believe that if commission costs are included in assessing best execution, any incentive which adds to or diminishes the costs should be captured. However, we are also concerned that any unfairness in allocation of benefits between consumers and any arrangements which cost consumers but provide no benefit for them should not be permitted. We do not think disclosure can solve all consumer protection issues.

**Q3 Do you agree that the current emphasis on immediacy should be replaced by a more general obligation to deal at the time judged by the firm to achieve the best result for the consumer?**

Yes. However, we suggest that, where a firm decides to delay execution of an order, it should be required to document the reason for so doing and to inform the customer accordingly.

We agree that the FSA should not specify a price benchmark in best execution requirements in a way that creates a 'safe harbour' for firms. However, we think that firms will have to be able to show what benchmark they use in monitoring their own achievement of best execution.

**Q4 Do the three categories of information discussed above (on pages 23-24 of the CP) capture all the relevant information that a customer needs to be adequately informed about the execution services provided by firms? Would information on actual order flow be more useful than a list of venues?**

In the case of execution arrangements, it is particularly important that consumers are informed about the steps the firm takes to ensure that it obtains the best result for its customers. We have described above our concerns about how best to protect consumers where there are conflicts of interest.

**Q5 Should the information provided by investment management firms be different to that provided by brokers? Have the key differences been identified? Have all the key conflicts of interest relevant to investment management firms been identified?**

We do not feel we have the expertise to reply to this question in detail.

**Q6 Are these the best options (see pages 27-28 of the CP)? Are there any others? What are the respective costs likely to be?**

We support the aim to ensure that information on execution arrangements is made available to customers before they start to do business with a firm; that it is clearly related to the way in which the firm intends to deliver best execution to its customers; and that changes to that information which are relevant to continuing judgements about the nature of the firm's execution arrangements are provided to customers in a timely way. As we have already said we think some kind of prescribed format for the information should be explored.

However we are not as firmly opposed to the provision of information on contract notes as the paper. Although by definition it could not influence the choice of a firm for that trade, it could serve an educational purpose, especially if some prescribed format can be found for giving the information. Banks put major contract terms on the reverse of statements and this serves a useful way of informing customers about matters which should be of interest to consumers when thinking about changing their accounts.

A combination of the options described in paragraphs 4.19-4.23 of the CP would seem to be best from the retail consumer's perspective. We have no comment on the respective costs of the various options.

There may be some role for financial promotion rules.

**Q7 Have we identified the key factors that are relevant to a review of execution arrangements? What issues do an assessment of price quality raise, and what criteria might be used for such an assessment? Is the data necessary to carry out this type of review available? If not, are market solutions likely to provide it? Is there a role for regulatory standards in specifying the broad format of the data that should be provided by execution venues?**

We believe that the key factors relevant to a review of execution arrangements are identified in the CP. Practitioners will be better placed to comment on issues surrounding price quality. However, one such issue would seem to be an inevitable element of subjectivity in any assessment of price quality. It would seem to us that historical data on prices will not always represent a true reflection of the market; the liquidity of the market will not be evident from price data alone. Accordingly, an issue for us would be verification of price data. Execution venues will certainly have a commercial interest in providing market information to help attract order flow, but who is going to check that the information is valid? Specification in regulatory standards of the broad format of the data that should be provided may be of some assistance in establishing consistency of information.

**Q8 Are these likely to be the main types of cost associated with carrying out a regular review of execution arrangements? How significant are these costs likely to be? Would carrying out the review as proposed add significantly to the costs already incurred by firms that perform similar reviews?**

We have no comments on the costs associated with the review.

**Q9 Do you agree with the proposed approach to coverage, process and frequency of execution quality monitoring? Is there a role for an industry standard on execution quality monitoring? If so, how might it best be produced?**

We agree with the proposed approach to coverage, process and frequency of execution quality monitoring. We would support the adoption of an industry standard on execution quality monitoring as a means of ensuring consistency of information made available to consumers. We suggest that the industry should be consulted with a view to the identification of what constitutes best practice in this respect.

The question in paragraph 4.44 does not appear to consider what the duty of a firm which discovers through monitoring that it has systematically failed to produce best execution would be to its consumers.

**Q10 Do you think that the proposals on execution quality monitoring would lead to additional costs for firms? If so, what types of costs would be incurred, and how significant would they be?**

The survey of current practice showed that firms are already assessing execution quality. For those firms that are already monitoring to the industry standard, no additional costs will be involved. It seems to us that firms will only incur significant additional costs where their method for assessing execution quality falls some way short of best practice.

**Q11 Do you agree with these conclusions on the scope of the best execution requirement (as listed in paragraph 5.16 on pages 36-37 of the CP)?**

Yes.

**Q12 Do you agree that the approach to best execution described above (on pages 37-38 of the CP) is applicable to programme trading? Is the method described above, the most appropriate method for monitoring execution quality for programme trades?**

We have no views on the extension of the regime to programme trading. This is not an area where we feel we should comment.

**Q13 Do you agree that the approach to best execution described in this CP is applicable to an internalised execution service as discussed above? Does internalisation pose risks to investors that are not adequately addressed by the approach to best execution proposed in this CP?**

Yes, we agree that the approach to best execution described in this CP is applicable to an internalised execution service as discussed in paragraphs 5.26-5.30 of the CP. We believe that internalisation does indeed pose risks to investors. It is therefore vital that firms are required to demonstrate that their execution quality is such that the outcomes achieved through internalisation are consistently at least as good as - if not better than - those that could be achieved by execution on alternative venues.

**Q14 Is this (as described in paragraphs 5.31-5.32) the appropriate approach for crossing transactions?**

The approach described seems appropriate. We think there are similar risks to consumers in crossing transactions as in internalisation.

**Q15 Do you agree with this approach to the application of best execution to non-equity markets or where there are low levels of liquidity or an absence of comparable transactions?**

This is not an area where we know much and this may be indicative of a need for more light to be shed on these markets. We would be interested to know how much these markets are focused towards retail consumers. That said, the FSA's proposed approach seems sensible.

**Q16 Do you agree with this proposed approach to consumer awareness? Are there any other consumer awareness issues arising from the proposals in this paper that we should consider?**

If the FSA wants consumers to play a role in driving the competitive market in this area, it will need to develop a strategy to enable them to do so. It needs to take steps to heighten consumer awareness of the best execution requirement on firms; and consumers need to be better informed if they are to understand the information on execution quality which will be made available to them by firms. We suggest that the FSA's Comparative Tables have a leading role to play in helping consumers to assess execution quality. We have also suggested some form of prescribed presentation of material. We think that the FSA needs to work out the target audience and research the best ways of getting across the information, not simply by relying on the website or by information disseminated by the FSA, without any idea of whether it achieves its purpose.

Yours sincerely,



**Colin Brown**  
Chairman

Cc Anna Bradley  
John Tiner  
Michael Folger

FS Consumer Panel can be contacted  
c/o Consumer Panel Secretariat at the FSA  
Tel: 020 7676 0720 Fax: 0207 676 9711

Email: [enquiries@fs-cp.org.uk](mailto:enquiries@fs-cp.org.uk)  
Website: <http://www.fs-cp.org.uk>