AUTORITÉ DES MARCHÉS FINANCIERS

AMF

The Ombudsman's Case of the Month
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"Best execution" of orders or the relative importance of the total cost paid by the client

Since 1 November 2007, when the Markets in Financial Instruments Directive (MiFID) came into force, investment services providers have had to apply "best execution" rules. As such, they must prepare an order execution policy that describes the factors used and the trading venues[1] selected to obtain the best possible result for their clients. With this month's case, I had the opportunity to revisit the applicable principles, and more specifically those relating to the relative importance of the total cost[2] paid by retail clients.

The facts

Mr T. stated that, on 3 December 2015, he placed a buy limit order at EUR 12 for shares of X, valid until 31 December 2015. However, his order was not executed even though the price of the share in question reached EUR 11.995 on 15 December at 5:18 p.m. As this price was below the limit set, Mr T. had a legitimate reason to be surprised not to have acquired the shares of X.

In response to his complaint, his account keeper, institution A., told him that his order had not been transmitted to the traditional execution venue, Euronext, but to an alternative foreign execution venue[3].

Mr T. disputed the choice of this venue on the basis of the likelihood of execution and, moreover, did not consent to having his instructions executed on a venue that was not the usual one. As the failure to execute his order caused him harm, Mr T. sought my assistance to obtain compensation.

The analysis

I questioned the client's account keeper. The institution argued, first, that its "best execution" policy lists both the traditional platform and an alternative platform among the trading venues used. Additionally, it stated that the total cost of the trade was the most important best-execution criterion. The account keeper informed me that, under this policy, Mr T.'s buy order was therefore issued to an alternative trading venue authorised by a European regulator.

I was told that, in this instance, on 15 December 2015, an order for 635 shares of X was executed at EUR 11.995 on the traditional platform. This same amount was executed at EUR 12.00 on the alternative venue. However, as shown in the order book, a copy of which was provided to me, the account keeper stressed that Mr T.'s order could not be executed due to the presence of a number of other investors in the stock on the alternative venue. Under the order execution time priority rules, his order was not a priority according to the "price/time" market rule. In light of the above, institution A. confirmed its rejection of Mr T.'s claim.

The recommendation

First, since MiFID took effect, investment services providers have been required to prepare an order execution policy and provide it to the client. This takes the form of an appendix to the account agreement that clients sign

[1] Possible trading venues: regulated market, multilateral trading facility, systematic internaliser, or over the counter.
[2] The total cost shall be the price of the financial instrument, plus the costs relating to execution, including all the expenses incurred by the client that are directly linked to the execution of an order, along with the charges specific to the execution venue, clearing and settlement charges and all other charges that may be paid to third parties participating in the execution of an order (Article 314-71 of the AMF General Regulation).
[3] This can be a foreign regulated market (such as Equiduct, Xetra or the London Stock Exchange) or a multilateral trading facility. A multilateral trading facility, while not a regulated market, matches (buy and sell) orders – within the system and in accordance with predetermined rules – for financial instruments: the leading facilities are Chi-X, Turquoise, BATS, etc.

when opening their account, and entities must notify their clients of any material change to their execution policy. In that context, investment services providers may suggest trading venues other than the incumbent exchanges, such as alternative venues, if they believe these venues will allow them to obtain the best possible result when executing their clients' orders.

In this case, on reviewing institution A.'s order execution policy, I saw that the alternative venue in question was indeed listed as one of the trading venues selected by this institution. As such, I noted that clients are only required to give their prior consent to a trading venue when the order is executed outside a regulated market or multilateral trading facility[4]. However, as Mr T.'s order was not issued outside this type of trading venue, his consent was not required.

Furthermore, I observed that, in ranking its "best execution" factors, institution A. had made the best total cost paid by the client its first priority, not the likelihood of execution.
On this point, I noted that, while Article L. 533-18 of the Monetary and Financial Code does in fact cite several possible best execution factors, such as the speed, likelihood of execution, price and nature of the order, best total cost remains the most important one and is assessed on a case-by-case basis. Pursuant to Article 314-71 of the AMF General Regulation, *"Where investment services providers execute orders on behalf of retail clients, best execution shall be determined on the basis of the total cost".* In this regard, the Guide to Best Execution[5] stresses that *"when including qualitative criteria in the execution policy for retail clients, it should be remembered that total cost is the most important criterion for this category".* Total cost means the price of the financial instrument plus all other execution-related costs.

In any case, it is also generally recognised[6] that simply issuing an order, and its subsequent registration, does not necessarily imply that it will be executed, even if the price limit set by the client is reached. Orders are executed by applying two priority rules:

- first by price: a sell/buy order with higher/lower limits is processed before all orders at lower/higher limits, a market order, i.e. with no price limit, has priority over best limit orders and limit orders;
- and then by time: two orders in the same direction and at the same price are executed by order of arrival.

Given that institution A. regularly prioritises total cost over likelihood of execution, I was therefore unable to conclude that the non-execution of Mr T.'s order, which was issued to an alternative venue, constituted a breach by institution A.

The lesson to be learned

Due to the increased competition among trading venues fostered by MiFID, incumbent stock exchanges have been losing their monopoly since 2007. A number of alternative operators have emerged, making the financial market environment more complex and requiring that clients be provided clearer information.

It is important to be aware that, while these alternative venues offer attractive pricing, which has some effect on the total cost paid by the client, they do not necessarily always offer the same level of liquidity as the traditional regulated markets.

Clients certainly always have the right to give a service provider specific instructions (Article L. 533-18 of the Monetary and Financial Code), but in that case the provider no longer guarantees the priority that had been decided on to obtain the best possible result with regard to the items covered by the specific instructions (Article 314-72 of the AMF General Regulation).

Read more

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[4] Article L. 533-18.III.3 of the Monetary and Financial Code.

[5] AMF Position-recommendation 2014-07.

[6] See: Beware! One market order can hide another: what are the rules on the priority of execution of orders?