



The Association of Corporate Treasurers

**Comments in response to
*Implementing MiFID's best execution
requirements (Discussion paper 06/03)*
FSA, May 2006**

August 2006

The Association of Corporate Treasurers (ACT)

Established in the UK in 1979, The Association of Corporate Treasurers is a centre of excellence for professionals in treasury, including risk and corporate finance, operating in the international marketplace. It has over 3,600 members from both the corporate and financial sectors, mainly in the UK, its membership working in companies of all sizes.

The ACT has 1,500 students in more than 40 countries. Its examinations are recognised by both practitioners and bankers as the global standard setters for treasury education and it is the leading provider of professional treasury education. The ACT promotes study and best practice in finance and treasury management. It represents the interests of non-financial sector corporations in financial markets to governments, regulators, standards setters and trade bodies.

General

The ACT welcomes the opportunity to comment on this matter. Contact details are provided at the end of this document.

We believe that others are better placed to answer the specific questions in the DP and simply comment briefly on the few points of most concern to our members.

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Background to our comments

By the nature of the qualification we offer as a professional body, our membership working in non-financial sector corporates tend to work in large companies – although we do have members in smaller companies in a variety of roles.

Our focus with regard to MiFID has been to seek to ensure that larger companies are able to “opt up” to eligible counterparty status in order that they may avoid the costs and complications which more protected status is likely to involve. Of course best execution is one of those complications, bringing with it likely increased cost for the service provider – paid for, ultimately, by the client.

In passing we should note that our members would be very concerned if the position UK were to consider not allowing corporates to act as eligible counterparties under Article 24.3.

We now turn to provisions regarding best execution where it is relevant – for smaller companies, for larger companies which do not choose eligible counterparty status and for retail clients and for matters where eligible counterparty status is not available. We will not comment on the retail client position.

“Best execution” seems to be a relatively clear concept in agency/broker (order-driven) markets. The requirement that a firm consider “how to obtain the best possible result for its clients”¹ is appropriate. For systematic internalisers, the existence of the market in which the transaction may have been executed and its associated data flows simplifies the problem of a price comparator. We recognise the problem of illiquid markets where quotations are often historic or “notional”...We believe that the financial services trade bodies are in the best position to comment on these matters.

Our comments focus rather on dealer markets where “relatively clear” cannot be applied to the concept.

Best execution in dealer/OTC markets

1. At 1.30 and elsewhere, the Discussion Paper refers to the intention or requirement “to produce the best possible results for the execution of [client] orders to buy and sell financial instruments covered by MiFID”.

The concept of “best execution” as applied to the terms of the transaction being agreed in dealer/OTC markets seems to fall into the category of error known as

¹ See, e.g. 2.21 in the Discussion Paper

“category mistake” or “category error”². There is no trade to be executed on behalf of the client. The agreement is between principals and complete in itself³ – even if one side or both may also undertake other simultaneous or consequential transactions to lay-off or modify the risk. This is clearest in direct over-the-counter markets in derivatives.

The making of rules based on a category error is fraught with difficulty and probable unintended consequences. If the Level 1 and 2 Directives do indeed require implementation of best execution requirements in these markets, the very minimum of rule-making activity possible under the directive is called for and the scope needs to be minimised.

It is particularly important in this case as it mostly will be the smaller companies, not able to opt-up to eligible counterparty which will have to carry the costs. These are often the very companies which most need to use, for example, over-the-counter derivatives. Such companies’ narrow portfolios make it more difficult for them to carry their own risks.

It should be noted that even the most rudimentary internal control procedures for any material transaction in corporate client companies will address the possible market failure issues referred to in the Discussion Paper⁴.

In these dealer markets, even relatively small companies, not able to become eligible counterparties, are usually able to take quotations from more than one provider of the instrument under consideration. Before seeking quotations for a transaction, they can be expected to have looked into price formation in the market to enable them to take a view as to whether a price ultimately offered to them is *prima facie* “reasonable”. Larger companies which have chosen not to opt-up to eligible counterparty status are even better placed to do this. Only the very smallest of companies, treated as retail, may find it difficult.

If a corporate client, other than the very smallest, does not obtain a reasonable price in these circumstances that should be seen as a failure of internal control in the company rather than a failure of or requirement for regulation of the financial services industry counterparty.

In summary, broadly, outside retail on which we make no comment, there is no mischief which needs redressing by rules or regulation in these markets.

2. The DP recognises that consideration of what is “best execution” cannot just be concerned with price and gives some examples of other factors, taken from

² A category mistake, or category error is a semantic or ontological error by which a property is ascribed to a thing that could not possibly have that property.

³ Of course, there will be executory aspects of the matter of the contract, for example obligations to be carried out on maturity of an over-the-counter derivative.

⁴ E.g. at 3.16

Article 21.1. The BMA/ ICMA/ISDA response gives others. There can be other practical constraints even for large corporates, for example:

- dealing lines and credit approvals by the corporate
- need for confidentiality
- a desire to link the exact pricing of one deal into a hedging deal that must be executed simultaneously
- cut off times or other time pressures that become critical.

In other words factors that can be summed up as practicalities or convenience can be important determinants of what the client sees as best execution.

3. We have seen the comments in response to the Discussion Paper from the BMA, ICMA and ISDA⁵ and from LIBA⁶. We find much to support in their comments.

In particular we would be concerned at

- Any deliberate attempt at making or any unintended result which makes what are currently principal to principal markets into what one of the responses referred to above calls “quasi agency markets”.
 - Attempts to micro manage client relationships in relation to MiFID governed products which are often part of a far larger relationship between the client and the regulated party.
4. We have recently seen the consultation paper by the Autorité des Marchés Financiers⁷ on this aspect of MiFID implementation. They seem to take a more flexible attitude to confirming best execution, particularly in principal to principal markets. While making some reference to prices available in other forums apparently they intend to avoid the heavy use of benchmarking and to look at other factors such as maximum spreads. This does seem to be something of a lighter touch.

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⁵ <http://www.bondmarkets.com/story.asp?id=2524>

⁶ <http://www.liba.org.uk/publications/2006/DP063responsefinal.pdf>

⁷ AMF consultation of enforcing the best-execution principles in MiFID and its implementing directive, 25 July 2006, http://www.amf-france.org/documents/general/7274_1.pdf