BETTER FINANCE Answer to ESMA Consultation on the Technical Standards specifying the criteria for establishing and assessing the effectiveness of investment firms' order execution policies.

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Introductory Remark

BETTER FINANCE submits its response to ESMA's consultation on the *Technical Standards specifying the criteria for establishing and assessing the effectiveness of investment firms' order execution policies*. While ESMA's broader agenda includes reducing regulatory burdens for firms, BETTER FINANCE emphasises that, for retail investors, the new Level 2 RTS must prioritise clarity, usefulness, and the quality of information over quantity. It is essential that these standards effectively safeguard retail investors, avoiding excessive documentation and overly technical language that could hinder understanding.

To foster genuine investor protection and address past shortcomings, BETTER FINANCE calls for an approach that carefully balances and weighs granularity to ensure "best execution" assessments are meaningful while avoiding unnecessary complexity. Such granularity, coupled with regular monitoring, is crucial for firms to consistently work towards achieving the "best possible result" for clients as required under MiFID II. BETTER FINANCE raises concerns about several proposed proportionality measures that follow the already reduced reporting obligations (e.g. the deprioritization of RTS 27 and 28 reports, which previously required detailed public, quarterly and annual data on execution quality).

BETTER FINANCE also suggests that ESMA should be empowered to accredit execution venues to promote fair competition and uniform standards across the EU, as NCA oversight can be inconsistent. In our consultation response, we emphasise that without strong oversight, the vagueness of certain provisions cannot ensure cohesive application. We raise specific concerns over the flexibility allowed in grouping financial instruments (usefulness should be mandated) and the use of alternative benchmarks (reference datasets) or third-party monitoring. Additionally, we highlight that certain classification measures may create undue distinctions between retail and professional clients, ultimately disadvantaging retail investors. It is crucial that proportionality does not come at the expense of fairness, transparency, and effective best execution oversight.

BETTER FINANCE stresses the need for accuracy and reliability in the benchmarks firms use. While ESMA allows the use of alternative datasets, we advocate for making the Consolidated Tape (CT) an essential reference point for firms, providing an additional layer of accountability to enhance comparability. Given the early stage of the CT's development and its partial consolidation, BETTER FINANCE acknowledges that other reference datasets may be used if they demonstrate superior quality and come from non-affiliated, straightforward, and interpretable sources.

Furthermore, while BETTER FINANCE acknowledges ESMA's efforts to enhance transparency in execution venue selection, it emphasises that the proposed monitoring frequency may not be sufficient, particularly in volatile markets or when dealing with high-risk financial instruments. Specific criteria for when more frequent monitoring is necessary should be clearly defined to protect retail investors effectively.

BETTER FINANCE also supports ESMA's provisions for transparency regarding implicit costs associated with internalisation practices (e.g. mark-ups when firms trade as principal or counterparty), as such transparency is essential for ensuring fair treatment and price clarity for retail investors. To achieve these objectives, BETTER FINANCE urges the establishment of a unified framework guiding firms to develop concise, transparent, and comparable policies. These execution policies must convey key information on trading and execution conditions, including risks, conflicts of interest, and all associated costs. The ultimate goal is to empower retail investors with the information they need for informed decision-making, thereby enhancing overall market transparency and fairness.

Please refer to our consultation response below, where we detail our remarks and further elements.

Answers to ESMA's Consultation Document Questions

1) Requirements for Establishing Investment Firms' Execution Policies

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 as an alternative? Please state the reasons for your answers.

BETTER FINANCE acknowledges ESMA's approach and stresses the importance of balancing regulatory consistency and flexibility. The proposed classification standards are inherently technical and primarily intended for market participants (venues) or, to some extent, semi-professional individuals, experts, and professional investors. Therefore, it is essential that ESMA ensures these standards actually serve retail investors' needs, particularly in upholding best execution principles.

On one hand, the ISO standard may be useful for promoting consistency across firms in the EU and beyond. However, the classification's practical relevance must take priority to avoid fragmentation or the creation of dual approaches. On the other hand, the current MiFID II system already supports market transparency and is currently in use by investors, minimising the need for drastic changes. ESMA could also require firms to provide simplified categorisation for retail clients upon request to help them understand key distinctions (e.g. between EU and US securities classes).

Regarding clustering, BETTER FINANCE calls on ESMA to maintain sufficient granularity for proper analysis, as excessive clustering could obscure differences relevant to assessing execution quality. Therefore, ESMA could provide clearer guidance on when flexibility is appropriate, ensuring that firms justify clustering practices in an accessible manner – avoiding excessive, heterogeneous, discretionary practices. Clustering should not impair reporting or comparability, and firm-specific justifications must be outlined in the RTS.

We believe the RTS shall target standardisation to facilitate assessment, oversight and comparison – ensuring regulators can access relevant data while retail clients meaningful ones, without unnecessary complexity. Additionally, given the fragmentation in EU markets, ESMA should consider the effects of compliance, notably on market connectivity or its potential to foster consolidation. BETTER FINANCE support market integration through standards that do not create barriers for EU retail clients.

2) Pre-Selection of Venues and Single Venue RTS

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.

BETTER FINANCE wishes to stress that firms must clearly explain their venue selection process, particularly when only one venue is used to execute trades. Ideally, firms should present multiple venue options when available, providing a clear explanation of each venue's functionality, its implications for investors, and how these choices enable best execution under specific criteria.

Regarding pre-selection, ESMA should enhance consistency across the EU by accrediting venues based on harmonised, EU-wide minimum criteria to address discrepancies in Member States' oversight, especially in cases where approval processes are regionalised, such as in Germany, where NCA supervision may be limited. To maintain consistency, ESMA should work closely with NCAs to monitor compliance with these criteria and ensure firms' adherence to best execution standards, protecting retail investors effectively across all Member States.

When a dark venue is selected, firms must disclose how trades are internalised, including the mechanisms determining the execution price and any associated revenue practices, in clear and accessible language. BETTER FINANCE supports ESMA's approach but stresses the importance of providing specific warnings about the risks associated with dark pools or internalised trading, including detailed bid/ask spread disclosures and potential conflicts of interest.

ESMA should mandate that firms provide retail investor-friendly summaries, outlining essential elements like risks, costs, and venue functionality in plain language. This will help retail investors better understand the implications of the venue selection presented in best execution policies.

If a single venue is used, stricter best execution requirements must be enforced, particularly when making use of internalisation. While BETTER FINANCE agrees with ESMA's requirements, we suggest mandating more frequent assessments and monitoring to ensure compliance. Furthermore, firms should justify the mechanisms by which any larger bid-ask spread may be offset by lower explicit costs and disclose details about clearing and post-trade processes within their execution policies. To reinforce trust and transparency, BETTER FINANCE recommends that ESMA also require independent audits or third-party assessments of firms' compliance with best execution policies, particularly when using dark venues or internalisation practices, as these inherently involve conflicts of interest.

To improve choice and market transparency, BETTER FINANCE advocates for ESMA to require firms to offer an additional lit venue/regulated market option when a Systematic Internaliser (SI) is the default and sole venue selected by a firm. BETTER FINANCE supports ESMA's suggestion that if best execution is not achieved or under specific circumstances, firms must provide access to an alternative venue as a contingency. However, we believe this contingency plan should explicitly include the provision of a lit venue option, which must be pre-approved and clearly outlined within the firm's execution policy to ensure consistency and investor protection.

On benchmarking, objective criteria are essential. Firms should benchmark against standardised datasets, considering factors such as liquidity, historical performance, and cost comparisons with other venues. While BETTER FINANCE acknowledges the current limitations of the Consolidated Tape (CT), it should remain the preferred dataset for best execution comparisons. However, if firms choose to use alternative datasets, they must ensure these datasets are transparent, non-affiliated (i.e., the dataset provider must not have any involvement in assessing best execution for the same firm), and demonstrate quality equivalent to or more granular than the CT, particularly concerning pre-trade information.

Finally, BETTER FINANCE calls for better investor information on ex-ante transparency in cost information. Investors often require real time and consolidated views of all costs associated with their venue selection, which firms do not consistently provide, thus hampering comparability at the decision point. Firms should ensure that investors are fully aware of all potential costs they may incur, and optionally, they could offer a breakdown detailing explicit and implicit fees at the time of venue selection. This approach promotes clarity and protects retail investors by enabling them to make informed decisions that extend beyond the consideration of execution policies.

3) Consideration of Order Sizes for Retail and Professional Clients

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?

BETTER FINANCE acknowledges level 1 rules mandating ESMA's intention to differentiate order sizes for retail and professional clients, recognising their distinct trading characteristics. While this differentiation aims to tailor execution venues to specific needs, BETTER FINANCE believes further clarification are necessary to prevent discrimination and ensure fairness of treatment between retail and professional clients.

We suggest that the RTS should prioritise liquidity as the primary criterion for retail clients, rather than "frequency". Liquidity is more likely to directly impacts execution quality and is therefore more relevant for retail investors, who often engage in smaller trades. Emphasising frequency may indeed be more suitable for professional clients but does not provide significant value for retail clients, potentially adding unnecessary complxity.

Furthermore, the current RTS lacks specific criteria for retail order sizes and frequencies, which could lead to inconsistent application and discretionary practices by firms, potentially disadvantaging retail clients in order routing. BETTER FINANCE suggests that ESMA establish a standard market benchmark for retail orders, providing a consistent and transparent basis for best execution assessments and preventing to solely rely on subjective criteria that may lead to unequal treatment between clients and inconsistencies among firms' practices.

In addition, BETTER FINANCE proposes that at least one order size should be consistent across both retail and professional clients. This would allow for fair comparisons and uphold a level playing field, ensuring that retail clients are not disadvantaged by unjustified distinctions based solely on order size.

Lastly, BETTER FINANCE recommends that firms clearly explain how order sizes and liquidity considerations influence venue selection in their execution policies. This transparency would empower retail investors with the necessary information to understand how their trades are executed, fostering trust and ensuring that there is no undue discrimination between retail and professional clients.

4) Assessing the Effectiveness of Order Execution Policies

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.

BETTER FINANCE supports the overall ESMA's proposals for the criteria for establishing and assessing the effectiveness of investment firms' order execution policies but suggests essential refinements to enhance retail investor protection.

Firstly, a quarterly monitoring frequency may not be adequate, even under standard market conditions. BETTER FINANCE emphasises that more frequent assessments should be explicitly mandated, particularly during periods of high volatility or when firms engage with high-risk financial instruments. The RTS should provide clearer, more specific guidelines on circumstances that necessitate increased monitoring to ensure firms respond swiftly and safeguard client interests.

Secondly, firms must be required to provide summaries of their monitoring reports upon client request, with records systematically stored for comprehensive regulatory checks. This would enhance transparency and accountability, enabling both clients and regulators to effectively verify firms' compliance.

Finally, BETTER FINANCE highlights the need for more precise criteria within the RTS for triggering policy updates, rather than vague terms such as "execution quality falls short" or "significant changes occur," which may allow for discretionary interpretation by firms. Clear, objective guidelines should be established to ensure firms proactively adjust their execution arrangements when changes or deficiencies are detected, reinforcing the effectiveness of their policies and safeguarding retail investors and level the playing field.

5) Reliance on Third-Party Monitoring for Execution Quality

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.

BETTER FINANCE acknowledges ESMA's proposal allowing investment firms to rely on third-party monitoring and assessment, such as independent data providers, provided firms evaluate these third parties' processes. While this can enhance monitoring practices, BETTER FINANCE emphasises key considerations to protect retail investors and ensure transparency.

Firstly, firms should disclose their outsourcing arrangements clearly, detailing the data sources and third-party providers responsible for monitoring execution quality. This transparency helps clients understand the monitoring process and builds trust in firms' execution outcomes.

BETTER FINANCE also highlights that the term "firms' client base" is vague and may ultimately lead to inconsistent application across those. ESMA could rather provide clearer criteria to ensure third-party assessments align fairly with firms' diverse client categories, avoiding discriminatory practices that could disadvantage a category of retail clients. Assessments must reflect all client types accurately – and without bias.

Additionally, while third-party outsourcing can provide specialised expertise, it also poses risks to transparency and may create conflicts of interest. Firms should only engage independent providers with no affiliations to their operations, especially if benchmark or data providers are involved in assessment services. ESMA should enforce stringent requirements to ensure third-party independence and objectivity in light of such scenarios.

Moreover, firms must retain full accountability for best execution monitoring, regardless of third-party involvement. If discrepancies or legal issues arise, firms should remain liable to clients, ensuring continuous regulatory compliance.

Finally, the RTS should require firms to periodically review and align their execution policies with third-party assessments. BETTER FINANCE suggests that ESMA mandate regular evaluations of third-party performance, including conditions for reassessment if benchmarks are not met.

By implementing these safeguards, BETTER FINANCE believes ESMA's proposal can enhance monitoring practices while maintaining transparency, accountability, and fairness for retail investors.

6) Specific Client Instructions and Venue Selection

Q6) Do you agree with ESMA's proposal that when investment firms receive specific instructions from clients regarding the execution of their orders, the investment firm should warn the client when complying with such instructions may prevent the firm from obtaining the best possible result for the client? Please also state the reasons for your answer.

BETTER FINANCE supports ESMA's proposal requiring firms to warn clients when specific instructions may limit the best execution outcome. However, several safeguards are necessary to ensure full transparency and protect retail investors.

Firstly, the RTS should mandate clear, standardised warnings in simple language, ensuring clients fully understand the consequences of their instructions. Firms must also provide educational resources, helping clients comprehend how specific venue choices could impact execution quality, such as increased costs or reduced speed.

For BETTER FINANCE, retail clients should have full autonomy in choosing venues in case several are offered. Specifically, firms should avoid “nudging” clients towards specific venues by pre-selecting options – unless it can be clearly demonstrated that this option is the most favourable for the client. In cases where certainty cannot be guaranteed, firms should refrain from pre-selection altogether. Additionally, firms must provide transparency on how and why venues are ordered or prioritised in the selection process, ensuring clients have a clear, comparable view of all options available.

Finally, even when clients provide specific instructions, firms must still uphold their best execution obligations. ESMA should clarify that firms remain responsible for achieving the best possible outcome within the client’s parameters and document their efforts to ensure transparency and accountability.

7) Best Execution and Dealing on Own Account

Q7) Where an investment firm executes client orders by dealing on its own account (including back-to-back trading), given the specific nature of this execution model and its compliance with best execution rules, do you believe the current text is clear regarding the obligations an investment firm following such a model should comply with? Alternatively, would it be beneficial for the RTS to provide a detailed list and explanations of the information that should be included in the order execution policy, such as the method and steps the firm should take to establish the price of client transactions in back-to-back trading, or the methodology for applying mark-ups or mark-downs in such order executions? Please also state the reasons for your answer.

BETTER FINANCE agrees with ESMA’s proposal requiring firms to disclose how they manage conflicts of interest, particularly when dealing on their own account as internalisers. However, further refinements are needed to ensure retail investors receive comprehensive and clear information.

Firstly, it is crucial that the RTS mandates firms to explicitly state that, as internalisers, they act as counterparties rather than as “neutral” venues. Retail investors must also be clearly informed that the firm can engage in profits from the bid-ask spread as when routing their order they buy at the bid price and sell at the ask price. This should be presented as a strong, coherent warning, clearly indicating the inherent conflict of interest when the firm acts in this capacity. Firms should provide information on the potential loss when trading with internalisers versus trading on lit markets, where spreads are typically narrower due to greater competition and order books transparency. This would help clients make informed decisions while fully understand potential (dis)advantages.

BETTER FINANCE also supports ESMA’s requirements for pricing transparency but suggests that the RTS go further in specifying how firms should disclose their mark-up or mark-down methodologies (average and instrument-specific). It is essential that retail investors understand how these costs are calculated and the average impact of these mark-ups on their trades.

Finally, the RTS should enforce a standard for how this information is presented in the best execution policies, ensuring it is straightforward and accessible. Firms must minimise the use of technical language and clearly communicate the risks associated with trading with internalisers, including the counterparty risk.

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