Investment Management Association

MiFID One Year On

Execution Quality Data
MiFID Article 44.5

MiFID Implementing Directive Article 44.5 states that “before November 1 2008 the Commission shall present a report to the European Parliament and to the Council on the availability, comparability and consolidation of information concerning the quality of execution of various execution venues.” In order to inform the Commission’s report the IMA conducted a survey of members to gather views as to how the quality of information had changed since the implementation of MiFID in November 2007.

This report of the survey’s findings has been endorsed by the IMA’s Dealer Group. The IMA surveyed several member firms, both Heads of Equity Dealing and of Fixed Income Dealing, and Fixed Income managers, regarding the quality of data that they were receiving from execution venues. The report follows the questions which were asked in the survey interviews. Firms ranged from mid-size to very large asset managers in both sections.

IMA’s annual Asset Management Survey reported that IMA members managed about 44% of the domestic equity market for clients and £1.1trillion of fixed income instruments. The survey focuses upon these markets.

Key Points:

- Settlement certainty and counterparty risk have more recently often become the most relevant factor in the provision of best execution following the collapse of Lehmans[1] and the unprecedented number of trade failures in the London market.
- Brokers should be required to describe their execution policies and practices upon request.
- Members are unanimous that a consolidated tape should be introduced for all EEA equity markets.
- Members would like to see the introduction of order routing by EEA equity venues in similar fashion to Reg NMS in the US.
- Fixed income managers are generally content with the information that they are getting but note that all data have deteriorated in quality during the credit crunch.

[1] By which shorthand we mean Lehman Brothers International (Europe) Limited, now in administration

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Equities

1. *What information do managers need when selecting an execution venue? Price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration?*

Members agree that in normal circumstances price and volume (i.e. likelihood of execution) are the most important factors when selecting an execution venue. In current market conditions, however, the most relevant factors have become settlement likelihood and counterparty risk. This is likely to continue to be the case for some period of time. Costs such as commission are less important although implicit costs such as market impact are.

In executing agency trades dealers rely on their brokers to access suitable venues as part of their obligation to provide best execution. It is the case, however, that in order to fulfill MiFID requirements members do have to rely on their agency brokers for information which is inaccessible to them. Many members now ask their brokers for a monthly list of the execution venues which they have accessed on their behalf in order to monitor venue usage. Some concern is being expressed that brokers may be accessing venues which are cheapest for them rather than the most suitable for the client. Some members bar brokers from specific venues if they do not think that they give the best result for the client. IMA members believe that the requirement to monitor execution venues should be applied to brokers and the venues and not to the buy-side.

Many members agree that, with the fragmentation of markets post the introduction of MiFID, the introduction of a similar order routing rule to Reg NMS in the US would be highly beneficial in the EEA to the provision of best execution.

2. *Is the information you are getting from execution venues accurate? Is it in comparable form and is it verifiable?*

For most European markets transparency has improved marginally since the introduction of MiFID in November 2007, although IMA members believe that it is still not optimal and that regulators have missed an opportunity to improve data quality. The key issue, however, for equity dealers in the UK is that the transparency of the UK equity market has deteriorated significantly. The main factor behind this deterioration is the new criteria under MiFID for trade reporting. Compared to pre-MiFID, many more trades have delayed reporting, albeit made under the MiFID rules. This is causing confusion amongst practitioners, including the sell-side, and is resulting in inefficiencies in the search for liquidity.

In addition the fragmentation of trade reporting is leading in many cases to double (if not quadruple) reporting and therefore to a misleading picture of liquidity in the market. One member reported that one trade that he had executed had been reported four times – by his broker, by the exchange, by the other side's broker and by the prime broker. He was able to track the trade due to the fact that it comprised an odd number of shares. Members believe that the problem lies with reporting brokers rather than the venues.

It is also not clear whether the reporting venues allocate trades to the date and time when they were executed, or to the day the delay is lifted.

The quality of OTC reporting effected on the Continental markets appears often to be very variable. This ought to be remedied by closer supervision of reporting firms.

As well as the data produced by the data service providers being suspect as a consequence of the above, they still have a considerable amount of work to do to offer a reasonably priced and accurate post-trade service to their clients. For example it is not possible to have consolidated reports unless the client subscribes individually to each European exchange.

While volume information is suspect members believe that price information is accurate. Some members reported however that they have difficulty with confirming the time of execution with their brokers and that it has to be done by phone post trade confirmation.

3. *Is there a mismatch between what you want to see and what you are getting from various venues?*

There is a clear mis-match as described in question 2 and the major data service providers are not producing what the buy-side wants to see. With further market entrants coming on stream the situation is expect to worsen. Members are in agreement that they would like to see a real time consolidated tape across Europe.

4. *How often do you need to use a venue which is not listed in your execution policy? What are the reasons for doing so?*

Members' execution policies generally list the types of execution venues which they use and those which their brokers use for their agency trades. A list of brokers used for principal trades is generally attached to the execution policy. All members have a broker approval process which a new broker goes through before any trading commences and which also monitors existing brokers for continuing suitability. Members commented that it is very rarely that they use a venue not covered by their policy. If they did it would be because that venue had the liquidity they were looking for for a specific trade. It would still be necessary to have that venue go through the firm's approval process.

5. *What information do you need to evidence compliance with your execution policy?*

Members' order management systems (OMS) produce an audit trail of trade executions with regard to time and price which can be compared with market data e.g. VWAP or previous close. Those who have FIX use it for checking time and price. Compliance managers review transactions with a specific focus on those transactions which fall outside of a pre-designated tolerance range. The frequency of the compliance checks varies between firms.

Many members use an ITG service which produces an estimate of what the trade should have cost which can be compared with the actual cost.

Transaction cost analysis is used to monitor the execution quality of individual brokers and venues and is discussed with counterparties at regular review meetings. Given the failings however of the trade reporting regime, transaction cost analysis reports are currently unreliable. This in turn is causing difficulties in demonstrating to clients that the manager has achieved best execution.

6. *Do your brokers' execution policies give you sufficient information to enable you to comply with your own obligations under Article 45.5?*

All members have professional client status as defined in MiFID and therefore are entitled to best execution from their counterparties. Members, however, report that brokers will not reveal their execution policies, and in some cases describe them as "practices" which cannot be disclosed for commercial reasons. Brokers do not appear to give much weight to the MiFID requirement to provide reasonable further information to professional clients upon request.

The Lehmans collapse should have lessons about the clarity with which firms can tell where their brokers have traded.

Members often require that their brokers sign their own execution policies as confirmation that they have execution arrangements in place to accommodate their client's policies. In some cases execution policies have had to be exchanged several times between firms with heavy legal involvement.

7. *Regarding systematic internalisers how can you tell that you are getting the deal that you ought to be getting? Is there other information which you should be getting?*

In general the quotes posted by systematic internalisers are not credible given the size offered or the wide spread on the price. Members however do not differentiate as to whether their counterparty is an SI or not regarding principal trades. As to whether they are getting the deal they expect, members believe that price discovery is still on the main exchange, while post-trade data and indications of interest can flag liquidity. The problems with trade reporting however are currently distorting the picture of the market which members believe they should be getting.

Where firms use broker algorithms, dealers ensure that they understand how it works and therefore whether it suits the sort of trade they are trying to execute.

One member commented that technology was becoming a barrier to entry for those dealers who want to access liquidity via dark pools. Sophisticated order management and execution management systems were increasingly necessary in order to get the best deal.

8. Do you rely on algorithms?

Most firms use algorithms to some extent but comment that they are only part of the tool set that they have. A dealer makes the decision as to how to trade an order and if he believes that it would be best done with a certain algorithm then that is his judgment to make. Members were concerned to point out that it was the professionalism and skill of their traders which was key to achieving quality execution and was not down to the use of algorithms.

9. If there is a venue which you do not use, are you getting information so that you can continue to review that venue?

Members are interested in any venue which they are not currently using and closely monitor all venues, existing and new, to ensure that they are able to access all sources of liquidity. There may be some venues which dealers do not use because of past poor experience in order execution. In this case the dealer instructs his broker not to use this specific venue for his orders.

10. Is there any other information which you would like to have?

Members unanimously support the introduction of a consolidated tape which is rigorously vetted for the accuracy and the integrity of the data. The tape would have to be monitored for double counting of trades and should include a flag to indicate the type of trade e.g. an internal cross.

The cost of accessing transaction data should be lower. Many members are not able to afford to pay the fees demanded by some data service providers to access basic data.

In order to improve transparency IMA members ask the Commission to review the rules covering the reporting of delayed trades. While it is likely desirable that there is a delay mechanism, the system is not currently working well.

Brokers' policies as to where they print trades are too loose and lead to a lack of transparency. IMA members would like to see where brokers have printed their trades.

Fixed Income

1. What information do managers need when selecting an execution venue? Price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration?

In common with equity dealers the most important considerations are price and liquidity. Members use a variety of information sources:

- a judgment of where a bond should be trading referenced to the relevant government bond;

- CDS spreads can provide useful input into judging where the underlying cash bonds should be trading;
- Bloomberg's AllQ page displays a composite of brokers' prices and is principally of use in liquid stocks;
- market maker runs may indicate where they have positions;
- Bloomberg messages indicate which venue has certain positions and can be used to filter on relevant criteria;
- counter-party relationships are important in obtaining a sense of where liquidity may be found.

Managers are generally happy with the information that they get from their execution venues.

2. *Is the information you are getting from execution venues accurate? Is it in comparable form and is it verifiable?*

Displayed information is always indicative and is subject to negotiation between both counter-parties. It can only be verifiable once the trade has taken place. The degree of accuracy of displayed prices also depends on the type of bond involved. The information contained in market maker runs is also only indicative.

Market makers control the information which they report back as they often do not want to give away sensitive information. Some may indicate via a Bloomberg message that they have dealt in a certain issue at a certain level.

The transparency and accuracy of information in the fixed income market have deteriorated over the past year as a result of the credit crunch, and not as a result of the introduction of MiFID which has had little impact on the operation of the market.

3. *Is there a mismatch between what you want to see and what you are getting from various venues?*

Members believe that they get enough pre-trade transparency from execution venues. There is a clear trade off in the OTC bond market between transparency and liquidity. Members believe that the balance between transparency and liquidity in the market is probably fairly balanced. More pre-trade transparency would be detrimental to the provision of liquidity. Some members however commented that there could be a little more post-trade transparency, although again too much would lead to a reduction in liquidity.

4. *How often do you need to use a venue which is not listed in your execution policy? What are the reasons for doing so?*

Members infrequently use a venue which is not listed in their execution policy, although in current market conditions one member commented that he had explored alternative venues. A new venue would be added typically where a specific market is not covered by the venues on a firm's existing list. A new venue has to go through firms' broker approval process before trading commences.

5. *What information do you need to evidence compliance with your execution policy?*

Members typically print out the Bloomberg AllQ screen at the time of execution which is archived together with the details of the actual trade. If the price at which the trade was executed is different from that which is displayed, this is accompanied by an explanatory note. Compliance departments do tolerance checks to highlight trades which are outliers relative to a benchmark or to the price displayed. Where it is practicable, members obtain quotes from several venues for comparison purposes. Where liquidity is poor or where opening up their position would be detrimental to obtaining the best result for the client then mangers have to use their judgment as to how many venues should be approached.

6. *Do your brokers' execution policies give you sufficient information to enable you to comply with your own obligations under Article 45.5?*

7. *Regarding systematic internalisers how can you tell that you are getting the deal that you ought to be getting? Is there other information which you should be getting?*

8. *Do you rely on algorithms?*

The above questions are not applicable in fixed income OTC markets.

9. *If there is a venue which you do not use, are you getting information so that you can continue to review that venue?*

Members believe that they continue to receive information on venues which they do not use although in some cases if the venue is a broker the information flow is cut off. Practitioners are in constant contact with electronic trading venues whether they use them or not and are informed of new trading platforms.

10. *Is there any other information which you would like to have?*

Members agreed that in normal market conditions they receive enough information. Several members did think that a bit more post-trade transparency would be helpful.

Conclusions:

Equities: The clear message is that information quality across Europe still has significant room for improvement, and that as far as UK equities are concerned information quality has significantly deteriorated. The main factor behind this are the trade reporting requirements which allow trades to be reported to different venues rather than to a central exchange or venue, and which has led not only to a fragmentation of data but also to double (or more) counting. The delayed reporting rules under MiFID have also led to confusion. Members do not now have as clear a picture of liquidity in the market place as they had before. In addition transaction cost analysis systems are likely to be picking up inaccurate data giving rise to unreliable reports. Members use TCA to demonstrate best execution to clients.

Members are also unanimous in calling for a consolidated tape as in the US and would welcome the introduction of a rule for order routing similar to Reg NMS in the US.

Fixed Income: As far as fixed income members are concerned they believe that there has been little change in the information they are provided with since the implementation of MiFID. Fixed income managers are managing with the information they receive and believe it is the best available, but note that all data has significantly diminished in quality throughout the period of the credit crunch.

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