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WORKING DOCUMENT

From: Presidency

To: Working Party on Financial Services and the Banking Union (MiFID-MiFIR)

Subject: Payment for order flow
- Presidency Non-paper

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Payment for order flow

Presidency non-paper

The Presidency proposes to use the PFOF under strict conditions that impose restrictions in the form of best execution conditions and an explicit need for price improvement.

The investment firm receiving PFOF (PFOF recipient) must meet the conditions that the price is better than or equal to the EBBO provided by the CTP with a slight margin of error (2 %), but on average the investment firm should be in the EBBO spread. There is a cap on the costs borne by the retail client, which is comparable to the cost at which the retail client order would be settled on the biggest trading venue in that Member State. The word in square brackets “[or]” or “[and]” is for discussion; the best execution condition must be met in all cases, but further consideration is needed as to how it would be approached.

If the investment firm does not meet these requirements, the order should be executed in a liquid and competitive trading venue - the definition of a trading venue is for Member States to discuss.

In order to provide the retail with evidence of compliance with these conditions, the PFOF recipient must provide the retail with the statement of execution proving the required price improvement of the executed retail orders. The inspiration for the proposed model was the statement of fees under PAD, which has worked for payment services over the past several years without major issues. The Presidency considers this approach to be more efficient than transaction-by-transaction reporting, as it is administratively burdensome, and experience shows that retail does not rely on it much. In contrast, experience with annual cost calculations has been positive.

Member States should have a list of PFOF recipients and ESMA should also maintain and publish on its website a list of all PFOF recipients in the Union. This would be a useful tool also in cases where the CTP may provide the PFOF recipients with the data necessary to comply with the conditions set out in paragraph 2b. The limitation of use of this data is only for PFOF recipients, but the legislator should not impose conditions that are not technically feasible, so a means of meeting the EBBO condition was added to the proposal.

The sanctions are already provided for in Article 70(3) point (a)(xiii).

ESMA shall provide the Commission with an analysis of the use and functioning of the PFOF for the purpose of better regulation and possible early intervention.



EU2022.CZ

Existing provisions

EC proposal

FR PRES proposal of 15 July

CZ PRES proposal for the CWP on 21 November

DIRECTIVE 2014/65/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of 15 May 2014

**on markets in financial instruments and amending Directive 2002/92/EC and
Directive 2011/61/EU**

(recast)

(Text with EEA relevance)

(6a) The practice of receiving remuneration, discount, or non-monetary benefits for routing clients' orders to a particular trading venue such as RM, MTF or systematic internalisers also in the text referred to as execution venue, has been a worldwide practice that has become more common also in the Union. As this practice becomes more common in some Member States, the need arises for further streamlining the conditions of providing Payment for Order Flow ('PFOF') to retail clients. To ensure the better position of retail clients in the case of PFOF, further conditions for use of PFOF have been placed on investment firms. With the use of PFOF, the conditions for best execution are thus more specified, and further requirements are established for price improvement. The price improvement should be reached in the current concept of best execution that covers the price of the financial instrument and the cost of settlement.

(6b) The price of the instrument provided to retail clients should be equal to or better than the European best bid and offer provided by the consolidated tape, but this might not be the case due to latency issue of Consolidated tape. There is always a possible margin for error by possibly deviating from this by 2 %, but on average the investment firm should be able to be inside the EBBO spread. The price improvement should fulfil the best execution, which contains not just the price of financial instrument but also the settlement cost. The cap on the settlement cost is the average cost the retail client order would be on the biggest trading venue in the Member State where the PFOF is provided. These conditions need to be in combination that the best execution is provided. To enable the investment firm to



comply with the conditions set out for PFOF, the consolidated tape provider should be allowed to provide the necessary data to the investment firm receiving the PFOF. That is why the scope of consolidated tape was broadened, but only for the limited amount of investment firms receiving PFOF that should be in the register of Member State as well as ESMAs’.

(7) Article 27(3) of Directive 2014/65/EU contains the requirement for execution platforms to publish a list of details relating to best execution. Factual evidence and feedback from stakeholders has shown that those reports are rarely read and do not enable investors or any users of those reports to make meaningful comparisons based on the information provided in those reports. As a consequence, Directive (EU) 2021/338 of the European Parliament and of the Council²² suspended the reporting requirement for two years in order for that requirement to be reviewed. Regulation (EU) XX/XXXX¹ has amended Regulation (EU) 600/2014 to remove the obstacles that have prevented the emergence of a consolidated tape. Among the data that the consolidated tape is expected to provide is ~~pre-trade (top of order book quotes) and~~ post-trade information regarding all transactions in financial instruments. That information ~~can~~ may be used for ~~proving~~ documenting best execution. The reporting requirement laid down in Article 27(3) of Directive 2014/65/EU will therefore no longer be relevant and should therefore be deleted. **New requirements should be added to Article 27 in order to specify how the data should be used to document the quality of execution of retail orders by brokers.**

Article 27

Obligation to execute orders on terms most favourable to the client

1. Member States shall require that investment firms take all sufficient steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. Nevertheless, where there is a specific instruction from the client the investment firm shall execute the order following the specific instruction.

²² Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending Directive 2014/65/EU as regards information requirements, product governance and position limits, and Directives 2013/36/EU and (EU) 2019/878 as regards their application to investment firms, to help the recovery from the COVID-19 crisis (OJ L 68, 26.2.2021, p. 14).

¹ COM 727



Where an investment firm executes an order on behalf of a retail client, the best possible result shall be determined in terms of the total consideration, representing the price of the financial instrument and the costs relating to execution, which shall include all expenses incurred by the client which are directly relating to the execution of the order, including execution venue fees, clearing and settlement fees and any other fees paid to third parties involved in the execution of the order.

For the purposes of delivering best possible result in accordance with the first subparagraph where there is more than one competing venue to execute an order for a financial instrument, in order to assess and compare the results for the client that would be achieved by executing the order on each of the execution venues listed in the investment firm's order execution policy that is capable of executing that order, the investment firm's own commissions and the costs for executing the order on each of the eligible execution venues shall be taken into account in that assessment.

2. An investment firm shall not receive any remuneration, discount or non-monetary benefit for routing client orders to a particular trading venue or execution venue which would infringe the requirements on conflicts of interest or inducements set out in paragraph 1 of this Article and Article 16(3) and Articles 23 and 24.

2a. To fulfil the best execution requirements as referred to in paragraph 1, first subparagraph, an investment firm receiving a remuneration, discount or non-monetary benefit for routing retail client orders in relation to shares or exchange-traded funds initially admitted to trading in the Union to a particular trading venue or systematic internaliser shall in addition to the conditions set in paragraph 2, ensure a price improvement to the execution in terms of the total consideration by ensuring that:

(a) the price of the share or the exchange-traded fund does not diverge per trade to the detriment of the retail client by more than [2 %] from the European best bid and offer as provided by the consolidated tape in accordance with Article 27h(1)(e) point (iv) of Regulation No. 600/2014; [or] [and]

(b) the cost relating to the execution on behalf of retail client of the order as referred to in the second subparagraph of paragraph 1 is equal to or lower than the cost for the execution on behalf of retail clients derived from the regulated market or MTF with the highest trading volume located in the Member State where the retail client is domiciled;



[2b. Paragraph 2a shall not apply to orders executed on a trading venue [where in respect to the share or the exchange-traded funds more than one person is acting as a market maker] or [applying a central limit order book or periodic auction system].]

2c. Member States shall ensure that the investment firm provides the retail client, at least annually and free of charge, with a statement of executions of each order for which the investment firm received a remuneration, discount or non-monetary benefit for routing the retail client order to a particular trading venue or systematic internaliser as referred to in paragraph 2a.

2d. The statement of executions shall specify at least the following information for each trade:

(a) the transaction price and volume executed at the stated price, the market identifier code identifying the trading venue or systematic internaliser, the standardised instrument identifier that applies across venues, the timestamp information on all of the following and the time of execution of the trade;

(b) European best and bid offer spread as published by the consolidated tape provider in accordance with Article 27h of Regulation No. 600/2014 at the time a transaction takes place on one of the venues where the share or ETF is traded;

(c) costs relating to the execution of the retail client order;

(d) comparisons that demonstrates a price improvement to the execution of an order in total consideration in accordance with paragraph 2a .

2e. The statement of executions shall:

(a) be presented and laid out in a way that is clear and easy to read, using characters of a readable size;

(b) be accurate and not misleading, and

(c) be written in the official language of the Member State where the investment service is offered or, if agreed by the retail and the investment firm, in another language.

~~3. Member States shall require that for financial instruments subject to the trading obligation in Articles 23 and 28 Regulation (EU) No 600/2014 each trading venue and systematic internaliser and for other financial instruments each execution venue makes available to the public, without any charges, data relating to the quality of execution of transactions on that venue on at least an annual basis and that following execution of a transaction on behalf of a client the investment firm shall inform the client where the~~



~~order was executed. Periodic reports shall include details about price, costs, speed and likelihood of execution for individual financial instruments.~~

4. Member States shall require investment firms to establish and implement effective arrangements for complying with paragraph 1. In particular, Member States shall require investment firms to establish and implement an order execution policy to allow them to obtain, for their client orders, the best possible result in accordance with paragraph 1.

5. The order execution policy shall include, in respect of each class of financial instruments, information on the different venues where the investment firm executes its client orders and the factors affecting the choice of execution venue. It shall at least include those venues that enable the investment firm to obtain on a consistent basis the best possible result for the execution of client orders.

Member States shall require that investment firms provide appropriate information to their clients on their order execution policy. That information shall explain clearly, in sufficient detail and in a way that can be easily understood by clients, how orders will be executed by the investment firm for the client. Member States shall require that investment firms obtain the prior consent of their clients to the order execution policy.

Member States shall require that, where the order execution policy provides for the possibility that client orders may be executed outside a trading venue, the investment firm shall, in particular, inform its clients about that possibility. Member States shall require that investment firms obtain the prior express consent of their clients before proceeding to execute their orders outside a trading venue. Investment firms may obtain such consent either in the form of a general agreement or in respect of individual transactions.

6. Member States shall require investment firms who execute client orders to summarise and make public on an annual basis, for each class of financial instruments, the top five execution venues in terms of trading volumes where they executed client orders in the preceding year and information on the quality of execution obtained.

7. Member States shall require investment firms who execute client orders to monitor the effectiveness of their order execution arrangements and execution policy in order to identify and, where appropriate, correct any deficiencies. In particular, they shall assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best possible result for the client or whether they need to make changes to their execution arrangements, taking account of, inter alia, the information published under paragraphs 3 and 6. Member States shall require investment firms to notify clients with whom they have an ongoing client relationship of any material changes to their order execution arrangements or execution policy.



8. Member States shall require investment firms to be able to demonstrate to their clients, at their request, that they have executed their orders in accordance with the investment firm's execution policy and to demonstrate to the competent authority, at its request, their compliance with this Article.

8a. Member States shall register all investment firms offering routing of the retail client orders in accordance with paragraph 2a. The register shall be publicly accessible and it shall be updated on a regular basis. Every inclusion shall be notified to ESMA.

ESMA shall establish a list of all investment firms offering routing of retail client orders in accordance with paragraph 2a in the Union; it shall be updated on a regular basis and published on its website.

9. The Commission shall be empowered to adopt delegated acts in accordance with Article 89 concerning:

(a) the criteria for determining the relative importance of the different factors that, pursuant to paragraph 1, may be taken into account for determining the best possible result taking into account the size and type of order and the retail or professional nature of the client;

(b) factors that may be taken into account by an investment firm when reviewing its execution arrangements and the circumstances under which changes to such arrangements may be appropriate. In particular, the factors for determining which venues enable investment firms to obtain on a consistent basis the best possible result for executing the client orders;

(c) the nature and extent of the information to be provided to clients on their execution policies, pursuant to paragraph 5.

10. ESMA shall develop draft regulatory technical standards to determine:

~~(a) the specific content, the format and the periodicity of data relating to the quality of execution to be published in accordance with paragraph 3, taking into account the type of execution venue and the type of financial instrument concerned;~~

(b) the content and the format of information to be published by investment firms in accordance with paragraph 6-;

(c) the requirements for the calculation of the costs relating to the execution of an order as referred to in paragraph 2a point (b);



(e) standardised presentation format of the statement of executions as referred to in paragraphs 2d and 2e.

~~ESMA shall submit those draft regulatory technical standards to the Commission by 3 July 2015.~~

ESMA shall submit those draft implementing technical standards to the Commission by [one year from application].

Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.

11. ESMA shall by [4 year after the application of the directive], present a report to the Commission on the functioning of the regime set out in paragraph 2a and fulfilment of the conditions set in paragraph 2a.

...

Sanctions:

Article 70

Sanctions for infringements

3. Member States shall ensure that at least an infringement of the following provisions of this Directive or of Regulation (EU) No. 600/2014 shall be regarded as an infringement of this Directive or of Regulation (EU) No. 600/2014:

(a) with regard to this Directive:

(i) point (b) of Article 8;

...

(xiii) Article 27(1) to (8);



The provision in MiFIR that are related to the issue of PFOF (not part of MiFID revision):

Article § 27h of MiFIR

1. CTPs shall, in accordance with the conditions for authorisation referred to in Article 27da:

(a) collect all market data provided through contributions in relation to the asset class for which they are authorised;

(b) collect monthly **or annually** subscription fees from users;

(c) in the case of market data concerning shares, redistribute part of their revenues for the purposes of covering the cost related to mandatory contribution and of ensuring a fair level of participation for trading venues, and in particular smaller regulated markets, ~~and~~ SME Growth Markets **and others trading venues providing initial admission to trading of shares and trading venues providing the best bid and offers available**, in the revenue generated by the consolidated tape in accordance with paragraph 5.

(d) in case of market data concerning asset classes other than shares, redistribute part of their revenue **fairly** for the purpose of ~~rewarding the quality and timeliness of data contributions~~ **covering the costs related to mandatory contribution**;

~~(de)~~ make consolidated core market data,

(i) for the provision of which the CTP is selected in accordance with Article 27da,

(ii) including the best bid and offer spread for share or ETF from the trading venues that offer trading in that instrument available at the time of the transaction on the trading venue where the share or ETF is traded;

(iii) the European best bid and offer spread, defined as the best bid and offer spread for a share or ETF available on the central limit order book or periodic auction system of the trading venues that offer trading in that instrument at the time a transaction takes place on one of the venues where the share or ETF is traded;

(iv) investment firm receiving remuneration for routing of retail client order in accordance with Article 27(2a) of Directive 2014/65/ES, the European best bid and offer spread, defined as the best bid and offer spread for a share or ETF available



on the central limit order book or periodic auction system of the trading venues that offer trading in that instrument around the time of a transaction takes place on one of the venues where the share or ETF is traded.

in accordance with the data quality requirements set out in Article 22b to users into a continuous electronic data stream on non-discriminatory terms as close to real time as technically possible.

(f) ensure that the consolidated core market data is easily accessible, machine readable and utilisable for all users, including retail investors.

[1a. CTPs may, in accordance with the conditions for authorisation referred to in Article 27da, provide the investment firm offering routing of retail client orders in accordance with Article 27(2a) of Directive No. 2014/65/EU with the European best bid and offer defined as the best bid and offer spread for a share or an ETF available on the central limit order book or periodic auction system of the trading venues that offer trading in that instrument.]