Elusive best execution

Will attempts to regulate the perfect trade help?

Since this year's markets may offer less than 2004's double-digit returns, it's timely that the concept of "best execution" to ensure every possible advantage when selling and buying securities is at the forefront again.

Best execution offers investors peace of mind, and aids in price discovery and efficient markets. However, it's a difficult concept to nail down because many factors need to be weighed—order size, type of security, order timing, the market of execution, and more—and each will be emphasized differently by individual investors.

Other jurisdictions have managed to codify in their own language what best execution means. For the U.K.'s Financial Services Authority, it's not solely about the lowest price, but rather the "best net result"—a vague definition if there ever was one. The SEC, on the other hand, has opted for more disclosure and compulsory reporting with its "Rule 5" and "Rule 6" provisions.

However, in Canada it has proved challenging to cement a definition for best execution. The regulatory authorities of British Columbia, Alberta, Manitoba, Ontario and Quebec, under the aegis of the Canadian Securities Commission, released a concept paper in May which outlined their take on best execution.

The CSC members asked for input on the paper, and they got it: some comments addressed the different needs of institutional investors, while others pointed out that best execution should be inherent in portfolio management policies. Daniel Chiu, director of capital markets at the CPPIB, echoed many other respondents when he wrote: "While the…guidelines provide a general template for the process of achieving best execution, [it] should be left to the discretion of the registrants."

Just as there's no optimal portfolio for every investor, there may not be a universal rule or test for best execution. While the efforts are laudable, this may be an instance where brokers should provide as much disclosure as possible, and let investors decide for themselves.

Editor's note: On page R7 of our Spring issue, Gia Steffensen was erroneously identified as the president of Legg Mason Canada—he is in fact executive vice-president and chief investment officer. Also, David Finstad's paper, "Institutional or Entrepreneurial Management?" contained several errors. Corrected versions of both articles are now on the CIR website. ∎

James Lewis, Managing Editor

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Canadian
Investment Review

James Lewis, Managing Editor
416-764-3958
james.lewis@bencan-cir.rogers.com
Elaine Fenech, Art Director

Paul Williams, Publisher & Vice-President
(416) 764-3848
Dale King, Associate Publisher
(416) 764-3915
Mia Crichton, Account Manager
416-764-3828
Karee Lang, Account Manager
416-764-3827
Gisela Stephany, Sales Manager Eastern Canada
514-843-2133
Jennifer Molleson, Production Manager
416-764-3928
Nancy Matheson, Director, Group Marketing & Communications 416-764-3816
Melissa Horwood, Conference and Promotion Planner
416-764-3865

Angela Bobotsis, Conference Editor
416-764-3834
Tricia Benn, Director of Research
416-764-3856
Cindy Younan, Circulation Manager
416-764-1443

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