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Mr Fabrice Demarigny
The Committee of European Securities Regulators
11-13 Avenue de Friedland
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IAIM Response to CESR's Consultation Paper Ref: CESR/07-050b
'Best Execution under MiFID'

Dear Sirs

Members of the Irish Association of Investment Managers greatly value their dialogue with regulatory authorities and believe that this is an essential, mutually beneficial, part of the regulatory process. We welcome the opportunity to respond to CESR's public consultation on Best Execution under MiFID and trust that our perspective will be of interest to CESR.

Our submission consists of:

- This letter, which provides a summary of our views, followed by further detail in relation to the aspects that we consider of particular importance.

- The attached Appendix, which contains responses to the specific questions contained in CESR's CP.

Summary and Overview

The members of the IAIM together manage in excess of €250 billion for a range of domestic and international clients and a key part of ensuring that we add value and meet client expectations is ensuring appropriately high quality execution of our investment decisions. As such the concept of best execution is central to our operations and we therefore very much welcome the publication of CP. We are in broad agreement with much of its content.

Notwithstanding this broad agreement, the tone and content of the CP do suggest interpretations by CESR which cause us concern. These include the apparent extension of the scope of Level 1 and 2 provisions, evidence of prescription, lack of flexibility and insufficient distinction between the obligations owed by executing entities and those elsewhere in the chain of execution. The terminology of the CP raises the prospect that the implementation of some of its content could have unforeseen negative consequences for market innovation and competition and that excessive prescription, as distinct from a principles-based approach, could also lead to reduced investor protection.

We are happy to confirm, following our attendance at the recent open hearing on this subject, that some of these reservations were alleviated by the statements made by CESR representatives at that forum. In particular, following the open hearing, our understanding is that;

- CESR's intention is to take a more principles based and industry led approach.
- CESR recognises the clear distinction between obligations under Article 21 (Level 1) and Article 45 (Level 2).
- Any apparent extensions of the scope of Level 1 and 2 provisions were largely unintended.

Aspects of Particular Importance

1. *Scope:*

    - The IAIM is of the view that the CESR CP outlines a perspective that could be considered to exceed the scope and application envisaged by the Level 1 and 2 Directives. In this regard, it would appear from the CP that CESR is seeking to extend, inter–alia, the provisions of the Directives on content of execution policies, monitoring obligations and the relative importance of total consideration. We welcome the clarification offered by CESR at the open hearing in this regard and the stated receptiveness to input from Industry.
    - We note the deferral of a more complete consideration of scope pending receipt of final clarification from the Commission. We welcome CESR's confirmation at the open hearing that an addendum to the CP will be issued for further consultation following this clarification. We do emphasise that the CP addresses the concept of best execution almost exclusively from the perspective of listed equities and that much of its content would have limited applicability in the context of e.g. structured products and the dealer markets in fixed income securities. We would expect that the content of the forthcoming addendum will be significantly different from the current CP.

2. *Differentiation Across the Chain of Execution:*

   The IAIM welcomes the laudable attempt in the CP to differentiate the nature of the respective obligations under Article 21 of Level 1 and Article 45 of Level 2, most notably in the context of "Chain of Execution". However, we are of the view that the CP in its entirety does not go far enough in making this distinction and that there are areas (possibly unintended) where CESR appears to be of the view that these obligations are analogous. Any such view would be inconsistent with the Directives and could dilute one of the principal objectives of MiFID, namely efficiency, by requiring duplication of activity across firms in the same chain of execution.

3. *Clarity of Language and Format:*

   Our members are of the view that the terminology used in certain areas of the CP could lead to confusion. The greatest confusion is due to the interchangeability of terms with different meanings and the usage of the same term e.g. "execution approach" to describe different concepts.

   Our members felt that there were some internal inconsistencies in the CP (although many of these were explained at the open hearing, where CESR gave a very welcome undertaking to clarify a number of these areas). The sections on "Professional Clients" (paragraphs 28-30) and "Content" (paragraphs 48-55) do not offer clarity in the conclusions reached.

4. *Prescription and Apparent Lack of Flexibility:*

   We welcome the clarification from CESR at the open hearing that it does not intend to take a prescriptive approach and that it endorses the principles-basis of MiFID implementation in general. However, the CP itself does include an unfortunate number of prescriptive statements. These include prescribing the content of a firm's execution policy and envisaging particular approaches for monitoring and review. Having had the opportunity to raise these matters at the open hearing, we welcome CESR's acknowledgement that a prescriptive approach is unwarranted and that firms and the industry must have the flexibility to tailor their best execution regimes to their particular business model.

5. *Total Consideration:*

   Our members have a number of concerns in relation to the proposals dealing with Total Consideration. In the first instance, there does seem to be an excessive level of reliance upon net cost as the determining factor in relation to whether best execution has been achieved. We believe this to be inappropriate, given that a variety of other factors (e.g. the speed and likelihood of execution, counterparty risk considerations, the overall standard of the service received and other regulatory considerations) may, depending upon the nature of the service being delivered, be seen to be more important. Furthermore, a firm can only be judged on the costs that are within its control and the

inclusion of custody and settlement costs in assessing whether best execution has been achieved, is inappropriate. One final high level concern in relation to the excessive emphasis on net cost is the possibility that a slavish and widespread emphasis on cost could lead to exclusive execution by all market participants at the cheapest venue, resulting in an ultimate reduction in competition.

6. *Departure from Standard/Duty Envisaged at Levels 1 & 2:*

Our members were concerned upon examining the CP, that CESR appeared to be departing significantly from standards envisaged at Level 1 and 2:

- The Directives clearly impose upon regulated firms an obligation to "take all reasonable steps" to secure best execution, while the CP, with its usage of terms such as "must", "will deliver" etc. appears to seek to impose a more absolute requirement.

- Furthermore, where the Directives refer to overall arrangements, the CP appears to envisage a client-by-client or order-by-order requirement.

Having had the opportunity to hear CESR's clarification of these aspects at the open hearing, we are satisfied that CESR's intention is consistent with the Level 1 and 2 provisions and welcome confirmation of this as the consultation process progresses.

Yours sincerely,

FRANK O' DWYER
Chief Executive

ENDA Mc MAHON
Chairman, Regulation & Compliance Committee

Appendix

IAIM Specific Comments Including Answers to Specific Questions Raised in CESR CP on Best Execution Under MiFID

Background Section

- Footnote number one on page 3 is the first example where terminology used may lead to confusion. The footnote indicates that the term "execution approach" is effectively interchangeable with "execution arrangements". It is subsequently stated that the "execution policy" is a significant element of "execution arrangements" (and therefore "execution approach") but also that the "execution approach" should be outlined in the execution policy. Later in the document it is suggested that PMs and RTOs be obliged to keep the "execution approach" of executing entities under review.

Execution Policy and Arrangements

Content of an (Execution) Policy

- We have a number of reservations in relation both to matters stipulated in the CP and to CESR's adoption of a prescriptive approach in this area.

- Concerning the appearance of prescription, we are somewhat comforted by CESR's general clarification at the open hearing that it is not seeking to be prescriptive and that these matters are generally up to the firm based upon its own business model. We would nevertheless urge CESR to remove any hint of prescription from its final recommendations to members in order to avoid a prescriptive rules-based approach to implementation and enforcement.

- We are of the view that CESR is going further than the Directives intended in its determination of the content of execution policy. Furthermore, the language used is very prescriptive and at odds with CESR's acknowledgement that a firm's arrangements, and by extension its policy, was very much a matter for the firm. The inclusion of the term "explain" in point (c) of paragraph 22 appears to require the firm to ensure that the client has a full and comprehensive understanding of the policy, when a more reasonable standard would be to use a term like "outline" or "describe". The usage of the term "will deliver" implies that the firm is obliged to ensure success in securing best execution which is a very significant departure from the "all reasonable steps" language of the Directives and should be removed. Finally, the reference to "those client orders" implies that a firm needs to satisfy the requirement on a client-by-client or case-by-case basis, which is very much at odds with the focus of the Directives on "arrangements". While we are now aware, following the open hearing, that these inferences were not intended by CESR, we would urge that the final recommendations to CESR member do not contain the above provisions.

- Footnote number 3 on page 7 also has the potential to cause confusion. Furthermore, we do not believe that extending the term "carrying out" to include placing orders is consistent with the Level 1 and 2 measures.

- **<u>To summarise, IAIM's response to Question 1 is:</u>**

    - **That CESR should highlight examples of the content that may be appropriate for an execution policy but that it should be made clear that such policies will vary from firm to firm or sector to sector and that the final decision will be a matter for each firm.**

    - **That an execution policy is likely to be a distinct part of execution arrangements but that prescription on this point should be avoided.**

    - **That an execution policy is likely to be a statement of the most important/relevant aspects of execution arrangements but, again, that prescription on this point should be avoided. The focus should be on the fact that important arrangements need to be properly put in place – and not in what document they are described.**

<u>Factors and Criteria</u>

- While this section contains much pragmatic guidance there is nevertheless an excessive reliance on the concept of "total consideration" in relation to which we have the following observations:

    - The emphasis on net cost is excessive and does not have due regard for the other factors, which may be at least as important in the relevant market or to a particular client, e.g. speed of execution, client preference, credit/counterparty risk considerations etc.

    - There could be unintended negative consequences for competition if all participants execute on the same (cheapest) venue.

    - The costs that a PM/RTO or executing entity should have regard for are only those that are (in accordance with Art 44 (3) of the Level 2 Directive) "directly related to the execution of the order" and therefore within the control of the firm placing/executing the order. As such, standard, market-driven costs that are outside the control of the regulated firm, e.g. settlement and custody, should not be taken into account.

- **<u>To summarise, our response to Question 2 is:</u>**

    - **While we believe that the "implicit costs" referred to are unlikely to be a very significant factor for routine retail client orders, the final position should avoid prescription and should allow a firm to have regard to factors other than price, where these are relevant and can be justified.**

<u>Professional Clients</u>

- We initially had some concerns in relation to the apparent contradiction between paragraph 30 and the earlier paragraphs. In common with many attendees at the open hearing, we believe that flexibility to give greater weight to other matters is paramount, in order to accommodate different priorities and markets. In that context, we welcomed CESR's clarification that firms have full flexibility to determine the relative importance of various measures that could be seen to be relevant to best execution and look forward to seeing CESR redrafting this section to make that point clearer in its final recommendations.

Possibility of a Single Execution Venue or Entity

- **The IAIM response to Question 3 is that there may well be situations in which it is advantageous to use a single execution venue. However, we would again urge CESR to avoid prescription in this regard and not to over emphasise the concept of total consideration. Our view is that the general requirement to secure best results and to review policies already cater for this without further guidance or prescription.**

Differentiation of the Policy

- **In relation to Question 4, we support the overall thrust of the CP in relation to the firm having flexibility to decide what information is required in order for the policy to be meaningful to the category of client. We feel that this is consistent with Level 1 and 2 discussions that concluded that there needs to be a balance between length and meaning. Finally, we endorse the general conclusion at the open hearing that it was appropriate for firms to give sufficient detail to be meaningful but not so much, e.g. a full list of all brokers, that it would need to be re-issued to clients very frequently.**

Disclosure

- **The IAIM response to question 5 is that we agree that it is completely at the discretion of individual firms to determine the level of "appropriate information" to disclose to professional clients. We are also in agreement with a number of attendees at the open hearing, who expressed the view that this is not a matter upon which regulation is required, insofar as client relationships and commercial considerations will ensure that such clients will receive all information that they require.**

Prior Consent/Prior Express Consent

- We welcome CESR's clarification in relation to tacit or implicit consent.

- We agree that this is generally a matter that will be governed by the law of contract in the member state where the contract is executed.

- **Having regard to Question 6, we welcome CESR's acknowledgement that prior express consent can be evidenced by a number of means, including electronic signature, in a telephone call etc. However, we feel that this concept should also have regard for market practice, as adverted to by CESR during the open hearing, e.g. where it is accepted practice for a contract to be concluded in the event that a contracting party lodges no objections to the draft contract within a stated period. Furthermore, we would like CESR to clarify that this requirement will only apply in situations where it is possible to execute on a regulated market and/or MTF and, for instruments, where there is no possibility of trading on a regulated market/MTF, it cannot apply.**

Chains of Execution

- We welcome the attempt that CESR has made to differentiate the obligations under Article 45 of Level 2, from the more rigorous requirements of Article 21 of Level 1.

However, we do not believe that the proposals make as clear a distinction as was envisaged by the Directives and that the current CESR position risks undermining a cornerstone aim of MiFID (efficiency) by requiring duplication of effort throughout the chain of execution.

- In common with other attendees at the open hearing, we feel that the usage of the term "execution approach" in Paragraph 68 is confusing, especially having regard to the usage of this term elsewhere in the CP. Further clarity is required here.

- **<u>In response to Question 7, the IAIM observes:</u>**

    - **We believe that obliging PMs/RTOs to do more that due diligence and monitoring of execution quality introduces duplication and is therefore at odds with MiFID in general and Recital 75 in particular.**

    - **We are of the view that monitoring execution quality (e.g. using price and success of execution as proxies) is sufficient for an RTO/PM and that to go further would be contrary to the "all reasonable steps" language of the Directives.**

    - **In particular, any obligation to assess the arrangements of the executing entity in detail would not only be impossible in practical terms but also pre-supposes that the RTO/PM has a firm view on the technical arrangements, systems, trading strategies etc. that are required to deliver best execution, which is clearly unreasonable. Furthermore, as Level 2 Art. 45(4) requires PMs/RTOs to take all reasonable steps to achieve the best possible results having regard to Level 1 Art 21(1), which does not require an execution policy. It would be inappropriate to require a PM/RTO to examine the executing firms execution policy.**

    - **We would like confirmation that, any breach by the executing entity does not constitute a breach by the RTO/PM.**

    - **We would also like to receive further clarity on the extent to which an RTO/PM can rely on the fact that an executing entity is regulated under MiFID and the measures that need to be taken in relation to third country brokers.**

<u>Review and Monitoring:</u>

- In common with other attendees at the open hearing, we believe that the differentiation between the "review" and "monitoring" becomes confused in this section at paragraph 85 (at the second bullet point).

- As we mentioned at the open hearing, we believe that prescription should be avoided. Flexibility should be facilitated and monitoring measures need to be proportionate to markets and be capable of differentiation by transaction type (e.g. a programme trade vs. full service transaction). Furthermore, any requirements need to be future-proofed having regard to the evolving nature of the markets - the concept of best execution in particular having evolved from "high low" to whole day "VWAP", intraday VWAP and now to measures such as implementation shortfall in just a few years.

- In addition, the CP seems to make sampling mandatory, whereas external benchmarking services may offer at least as good an evaluation of overall arrangements.

- We believe that it is debatable whether RTOs/PMs have access to all of the information envisaged by the CP.

- Finally, the oversight mechanisms should be complementary to and not analogous with the executing entities internal oversight as otherwise duplication would arise.

Execution Quality Data

The issue of best execution is a complex one. Evaluation depends on many factors including the instruments involved, the execution venue and the category of client. As was evident from the open hearing there are still core issues of interpretation and, indeed, scope to be resolved. In response to Question 8 we do not believe it is appropriate to determine the criteria against which execution quality will be evaluated until there is more information and greater clarity (including responses to the Calls for Evidence).

We believe the Calls for Evidence are important and warrant more time to generate robust responses. We hope CESR extends the deadline in the interests of an efficient approach to "the many uncertainties around execution quality statistics" and achieving genuine supervisory convergence.