



March 2007

Irish Stock Exchange Response to CESR's Consultation Paper on Best execution under MiFID

The Irish Stock Exchange welcomes the opportunity to comment on CESR's consultation paper on potential level 3 guidance on best execution and supports CESR's approach to promote supervisory convergence.

The Exchange is disappointed that the paper does not address questions in relation to the scope of application of best execution given that this is a fundamental consideration for firms when developing their best execution arrangements. Furthermore, while we understand CESR's decision not to cover scope in this paper pending a response from the European Commission, the Exchange and its member firms are concerned with the decision to delay this aspect of best execution given the significant impact it will have on firms' systems, procedures and policies.

Our response incorporates the views of the Exchange and those of its member firms.

Response to CESR Questions

Question 1: Do respondents agree with CESR's views on:

- the main issues to be addressed in an (execution) policy? Are there any other major aspects or issues that should ordinarily be included in an (execution) policy?
- the execution policy being a distinct part of a firm's execution arrangements for firms covered by Article 21?
- the execution policy under Article 21 being a statement of the most important and / or relevant aspects of a firm's detailed execution arrangements?

- (i) We agree with CESR's views on the main issues that the execution policy must address and that the execution policy is a distinct part of a firm's execution arrangements.
- (ii) In relation to the requirement to "set out the execution venues or entities the firm uses.....", we agree that the firm must maintain a detailed list of each of the execution venues and entities that are part of its execution arrangements. However, we do not believe that it is necessary for each of these entities to be listed by name in the firm's execution policy given that these entities may change over time. As an addition to or a deletion from this list could be considered a 'material' change, it would be quite impractical to require a firm to re-issue its policy to its clients every time it changes execution venue. We consider this to be particularly relevant in the case of the Retail Service Providers (RSPs) and Market Makers that a firm uses, as these could change quite frequently. We believe a more practical approach would be for firms to include in their policy that they may use RSPs and Market Makers to execute client orders, and for the firm to include a short description of the service provided by each type of entity.
- (iii) Furthermore, we would suggest that the wording of issue (d) should be revised from "explain why the firm's execution approach for carrying out client orders **will deliver** the best possible result for the execution of those client orders" to "explain why the firm's execution approach for carrying out client orders **takes all reasonable steps to achieve on a consistent basis** the

best possible result for the execution of those client orders” to take account of the wording used in Article 45 of Level 2.

- (iv) We agree with CESR’s interpretation of Article 21.

Question 2: For routine orders from retail clients, Article 44(3) requires that the best possible result be determined in terms of the "total consideration" and Recital 67 reduces the importance of the Level 1 Article 21(1) factors accordingly. In what specific circumstances do respondents consider that implicit costs are likely to be relevant for retail clients and how should those implicit costs be measured?

- (i) We consider that implicit costs may be more relevant to retail clients when such clients specify that immediate execution, non-standard settlement and other factors are more important for them. In particular, implicit costs are more likely to be relevant for non-equity markets, where certain instructions associated with an order or the characteristics of the financial instrument being traded may require firms to place more emphasis on some of the other factors to be considered rather than immediate price and cost. Therefore we believe that it should be emphasised that firms must use their own judgment in this regard and that the requirement of MiFID is to provide the “best possible result” for the client, which may be determined by factors other than price and cost, giving due consideration to the nature of the order and the markets, and the needs of the client. This approach should be adopted for both retail and professional clients.
- (ii) We believe that in certain circumstances, it may prove difficult to accurately measure implicit costs and therefore investment firms may have to use their own judgment here also. We welcome further clarification from CESR in relation to this.

Question 3: Do respondents agree with CESR’s views on the use of a single execution venue?

- (i) We agree with CESR’s views on the use of a single execution venue and welcome the flexible approach that CESR has taken in this paper.
- (ii) Furthermore we note that paragraph 38 suggest that investment firms should consider all execution venues for inclusion in their execution policy. However, we consider that it is not always practical to review every venue that is available for every financial instrument, and instead firms should be expected to review a reasonable number of venues based on their knowledge of the market and that other venues should only be seriously considered where market information indicates that liquidity or other factors affecting best execution has significantly moved to the other venue.

Question 4: Do respondents agree with CESR’s views on the degree of differentiation of the (execution) policy?

- (i) We agree with CESR’s views on the degree of differentiation of the (execution) policy.

Question 5: Do respondents agree that the 'appropriate' level of information disclosure for professional clients is at the discretion of investment firms, subject to the duty on firms to respond to reasonable and proportionate requests? On the basis of this duty, should firms be required to provide more information to clients, in particular professional clients, than is required to be provided under Article 46(2) of Level 2?

- (i) We agree that the 'appropriate' level of information disclosure for professional clients is at the discretion of investment firms, subject to the duty on firms to respond to reasonable and proportionate requests.
- (ii) However, we do not agree that more information should be provided to professional clients than is required to be provided under Article 46(2) of Level 2. On the contrary, we believe that professional clients may require less information than retail clients due to the level of expertise and knowledge that professional clients possess. This is supported by Recital 44 of Level 2 which states that “Professional clients should, subject to limited exceptions, be able to identify for themselves the information that is necessary for them to make an informed decision”.

Question 6: Do respondents agree with CESR on how "prior express consent" should be expressed? If not, how should this consent be manifested? How do firms plan to evidence such consent?

- (i) We welcome CESR’s practical interpretation of prior express consent.
- (ii) We consider that it is appropriate in an Irish context, for prior consent to be tacit.
- (iii) However, in relation to the requirement to obtain “prior express consent” from a client before “proceeding to execute their orders outside a regulated market or MTF”, we are concerned about the potential difficulty of obtaining prior express consent from existing clients who have already dealt in such a manner prior to the implementation of MiFID. It is felt that explicit consent should not be required from such clients once the execution policy has been provided to the clients and they have indicated a willingness to deal in such a way again by placing an order for execution with the firm post implementation of MiFID.

Question 7: Do respondents agree with CESR’s analysis of the responsibilities of investment firms involved in a chain of execution?

- (i) We agree in general with CESR’s analysis of the responsibilities of investment firms involved in a chain of execution. However, we would highlight that there may be practical difficulties in relation to this, in particular in obtaining information of execution arrangements of other intermediaries in the chain of execution who are also subject to the requirements of MiFID but may not release information on their execution arrangements in sufficient time for firms to analyse that information and comply with the requirement to provide clients with the execution policy “in good time”.
- (ii) We would also strongly emphasise the importance of Recital 75 of Level 2 regarding the intention of MiFID not to require a duplication of effort by firms so that when a firm passes an order to another firm that is also subject to the best execution requirements of MiFID, then the firm passing the order should be able to rely on the requirement of the other firm to comply with its obligations under MiFID.
- (iii) We also consider that CESR’s view in paragraph 68 that portfolio managers and RTOs must not only “monitor the execution quality of the entities they use, but also examine the execution approaches of these entities.....and keep these approaches under review” seems to place further requirements on portfolio managers and RTOs than MiFID intended.

- (iv) Furthermore, the requirement that firms must satisfy themselves that the execution arrangements of third country intermediaries or venues are sufficient to ensure the firm's compliance with article 45, as suggested by paragraph 74 of the paper, may also pose practical difficulties if adopted as the firm is dependent on such information being made available by these intermediaries even though they are not subject to the requirements of MiFID.

Review and Monitoring

- (i) We would emphasize that in the event that there is a new entrant to the market, it should be accepted that firms will need to be given a reasonable amount of time to assess the performance of the new venue and consider the suitability of it for the firm's execution arrangements.

Question 8: What core information and/or other variables do respondents consider would be relevant to evaluating execution quality for the purposes of best execution?

- (i) We note that CESR is currently working on the consolidation of transparency information and we would welcome further information in relation to this. However, we are concerned with the lack of information currently available to the market and the impact that this will have on a firm's ability to develop its execution policy before the implementation of MiFID.
- (ii) Member firms of the Irish Stock Exchange consider that price, cost, speed of execution, liquidity, volume at each price level, the total number and average number of orders received and trades executed on a daily basis, likelihood of execution, settlement success (particularly for non-standard settlement) and system reliability of the execution venue are essential parts of the core information required for firms to account for the relative importance of these factors in determining the execution policy. However we note that the level of information available in relation to these matters will depend on the type of instrument, the market etc.
- (iii) In relation to the monitoring and review of the execution policy, we would raise the point that the process of reviewing best execution should not be expected to be completed on a transaction by transaction basis but instead firms should be required to focus on the overall effectiveness of the policy rather than the specific results.
- (iv) Furthermore, we note that CESR's view to monitoring best execution appears to be limited to comparing transactions on the same venue or on a selection of venues that the firm has in its execution policy and that no mention was made of a requirement to also compare those venues that are outside of a firm's best execution policy although it would seem reasonable that such venues would also be tested when the firm monitors its execution policy on a periodic basis.

Call for evidence

- (i) In relation to paragraph 94, bid and offer quotes and traded prices are considered to be the only information currently available to the market to any significant degree. There is a need for more trade information to be made available in particular, the information noted in (ii) of our response to question 8 above.
- (ii) Competent authorities should expect firms to consider the overall performance of their execution arrangements taking into account the type of service the firm is providing, the type of instruments that it is evaluating, the market conditions at the time and the instructions of the client.

- (iii) In relation to paragraph 95, we strongly agree with the view that Article 21(5) requires only that the firm demonstrate that it followed its policies and procedures.
- (iv) In relation to paragraph 96, we welcome guidance from CESR in this area with a view to promoting supervisory convergence on the areas of data consolidation, pre- and post-trade transparency and execution quality data.