

IBF RESPONSE TO CESR CONSULTATION ON BEST EXECUTION

March 2007

Irish Banking Federation (IBF) is the leading representative body for the banking and financial services sector in Ireland, representing over 60 member institutions, including licensed domestic and foreign banks and institutions operating in the financial marketplace here.

I General Remarks

1. IBF welcomes the opportunity to comment on CESR's consultation on Best Execution. We would emphasise that clarity and prudent timing are key to this crucial aspect of MiFID, and that CESR must finalise its Best Execution guidelines in good time for implementation.

2. In terms of scope, IBF supports the interpretation advanced by industry in the UK, i.e. that Best Execution is owed where there is an existing client relationship, and the firm has undertaken an obligation to act on the client's behalf. Where there is a client relationship in existence but Best Execution is not owed, then other client protection measures such as conflicts of interest will apply. Thus in determining whether Best Execution is owed, it is **not** necessary to distinguish between investment activities and activities under MiFID. With the key factor being whether a client relationship exists (and a service is being provided), the following can be inferred:

- When a dealer is providing a 'request for quote' service to the client in cash fixed income markets they are not obliged to provide Best Execution as the dealer is not acting *on behalf of* the client. If the dealer is asked to search the market for a particular security on behalf of a client, then Best Execution is owed.
- When dealing in OTC derivatives, the dealer is not acting on the client's behalf, so Article 21 will not apply but Articles 18 (inducements) and 19 (conflicts of interest) will apply in such circumstances. This is because OTC derivatives are unique bilateral contracts for transferring risk- the contract is a discrete product that takes into account the client's instructions, and in doing so the dealer is under commercial obligations to service his client's will but is not acting on the client's *behalf*.

We note, from the open hearing, CESR's intention to issue an addendum to the CP and look forward to the opportunity to finalise a pragmatic interpretation of the scope of MiFID Best Execution requirements.

3. The very prescriptive nature of the guidance, as well as the interchangeability and overlap of key terms in the paper, are a cause for concern. We would advocate that CESR's guidance on Best Execution clearly reflects the flexible approach articulated in the Open Hearing on Best Execution of March 7. CESR should also clarify what elements of Best Execution it perceives as the remit of individual firm's own judgement. Accordingly, significant focus needs to be brought to bear on the final linguistic drafting of any guidance in order to ensure that it achieves its objectives.

II Responses to Questions Posed in CESR's Consultation Paper:

Execution Policies and Arrangements

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?*

4. The CESR paper articulates that an execution policy must "explain" factors that determine the execution approach. This exceeds what the Directives envisaged, and such an exhaustive explanation of factors would be of little added value to clients. A "reasonable description" is more appropriate than an "explanation".

5. While clause (b) and (c) can be clearly related to Article 46 (2) of the Implementing Directive, Clause (d) appears to go beyond the Directive- Article 46 (2) contains no reference to any obligation for the firm to explain why the firm's execution approach will deliver the best possible result.

6. Clause (d) also appears to go beyond the intent of the Directives given that the language of Clause (d) implies certainty and definitiveness: "the firm's execution approach for carrying out client orders *will deliver* the best possible result". This is inconsistent with the tone and language of the Directives: "investment firms take all reasonable steps to obtain, when executing orders, the best possible result for their clients" [Article 21 (1) Level 1].

Factors and Criteria

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?

7. It is difficult to envisage a scenario whereby implicit costs would be a factor for retail clients.

Possibility of a Single Execution Venue or Entity

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

8. The requirement to select venues based on "total consideration" for retail clients means that every firm must work with the cheapest provider of any service. This is incongruent with facilitating greater competition- one of the objectives of MiFID. This issue arises in the context of Single Execution Venue but is equally applicable to multiple venues (the firm must still select the cheapest venue every time).

9. We would suggest that the criteria be relaxed when selecting the venues for inclusion within a firm's order execution policy but probably not in the policy's application. Firms which are simply receiving and transmitting orders in respect of an execution-only dealing service, including many retail banks, will usually establish a single relationship with an execution entity. There are many important and practical considerations that lead to this single relationship. These include, for example:

- (a) the need to invest in the IT infrastructure supporting the arrangement and
- (b) the need to train a large number of staff in retail branches in how to operate the arrangement.

10. In these situations, it is not sufficient to simply take into account fees and commissions when determining which execution entity offers the best results for a retail client in terms of total consideration. We must also take into account the overall costs of operating the relationship. Increases in these costs will be passed on to the underlying clients.

11. The consequences of such requirements will be that all intermediaries will have to use the cheapest venues, potentially driving some out of the market, or the charges of all venues will converge. Either way, the consequence will be reduced choice and competition in the marketplace which conflicts with the objectives of MiFID.

Differentiation of a Policy

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

12. We have no apparent difficulties with CESR's view on the degree of differentiation of the execution policy.

Disclosure

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?

13. We support CESR's proposal that the interpretation of the level of information disclosure for professional clients is left to the discretion of investment firms.

Consent

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?

14. CESR's interpretation of 'Prior Express Consent' does not adequately reflect established market practices, for example, it does not provide for the admission of a default situation if the client fails to express any wish. The availability of a default option for establishing or renewing consent to policies is essential for firms' operations. This is particularly relevant where firms may have ongoing or periodic obligations (e.g. when discretionary activity forms part of a relationship, or on rollovers). In these situations, inactivity is also an action with consequences, and firms are therefore in jeopardy if a default position cannot be established.

15. We suggest that 'Prior Express Consent' should be taken to mean that a client is offered alternatives, and must consent to a specific option. Firms may also advise clients of a 'default' in case of a failure to choose, and in this context silence can be deemed to be such an expression of consent. As a matter of principle, consent can be expressed through silence, so a silent response is capable of being deemed 'express'.

16. We distinguish this situation from 'Prior Consent' which we take to mean acceptance or denial of a single option. Guidance could establish principles underlying how defaults can reasonably be expressed (for instance instructing the client that they can choose (a) (b) or (c) but in the absence of any response option (a) will be applied, otherwise the client should get in touch) and which are unacceptable.

17. This has great relevance to initial processes where best execution policies must be put in place. However it is not a once-off issue, because the same issues will come up with each amendment to the best execution policy. The active monitoring and review processes in MiFID are intended to ensure that the policy is being constantly updated, so the issues will recur frequently. Guidance regarding the acquirement of consent from a multitude of clients should take into account the logistical and practical problems experienced in previous exercises.

18. Equally, the issue of consent and interpretations thereof, cannot be considered in isolation of the law governing the contract; governing law should therefore be identified as a driving force in this context.

Chains of Execution

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

19. Paragraph 8 asserts that when RTOs review the results they obtain from the firms they do business with, that the RTO must compare these results with those delivered by other firms in the market. While we understand CESR's underlying rationale, we would be considered that the data required for such a comparison is simply not available.

Review and Monitoring

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?

It is too early in the process for us to be in a position to respond to this point.

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