Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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Central Bank inspection identifies poor best execution practices in investment and stockbroking firms

The Central Bank today (10 July 2012) published the outcome of a themed inspection into best execution in investment and stockbroking firms subject to the MiFID Regulations[1].

When investment and stockbroking firms purchase or sell financial products on behalf of their retail and professional clients, they are required to do so on a best execution basis. This means that they must take all reasonable steps to get the best possible result for their clients taking account of the price, speed, costs (commissions/fees), size of the order and other relevant factors. Firms must ensure that the information provided to clients is of a sufficient quality for the client to make a properly informed decision about whether to use the investment services offered by the firm.

The inspection raised a number of issues in relation to the best execution practices in the firms reviewed. As a result the Central Bank is requiring those firms to review their best execution arrangements.

Director of Consumer Protection, Bernard Sheridan said: 'Clients must have confidence that investment and stockbroking firms will act in their best interest at all times, and will have arrangements in place to ensure that all reasonable steps are taken to deliver the best possible result for them. Best execution is a crucial aspect of client protection. It is important that the highest standards of due care and diligence be followed by a firm when carrying out orders for clients.'

[1] The European Communities (Markets in Financial Instruments) Regulations, 2007

The inspection was conducted in two parts. Initially a desk based review examined the best execution policies and procedures of 32 investment and stockbroking firms with retail clients. Best execution policies are important as they set out the firm's decision making process in selecting an appropriate means of trading each client order. These policies must detail how client orders are executed fairly and promptly. Following this initial review, the Central Bank followed up by inspecting three firms to examine how their policies were implemented in practice.

The main issues identified by the Central Bank are:

Desk based review

1. In general, firms' policies were generic in nature and were not specifically tailored to their individual business activities;
2. More than one third of firms did not highlight in their policies that the total cost of a transaction is the main factor in determining the best possible result for their retail clients;
3. In their communications with clients, more than three quarters of firms did not provide retail clients with sufficient information regarding their policies. In particular, they did not set out important information regarding how and where trades would be effected.

Onsite Inspections

1. Differences were identified between firms' policies and how they were applied in practice;
2. In a number of cases, firms had difficulty in providing sufficient evidence in order to demonstrate that they had followed their best execution policy;
3. Firms did not carry out sufficient monitoring to ensure that transactions complied with their policies;
4. Firms did not maintain evidence of how they monitored on a regular basis the effectiveness of venues and entities used for execution.

A copy of the letter to industry is available on our website www.centralbank.ie [*this should be replaced with a hyperlink to the actual letter when it has been published*].

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ENDS

Notes for editors:

About the MiFID Regulations

The European Communities (Markets in Financial Instruments) Regulations, 2007 ('MiFID Regulations') is a comprehensive regulatory regime covering investment services and financial markets in Europe and introduces common standards for investor protection throughout the European Union. It applies to both investment firms and credit institutions when providing investment services, and to regulated markets. The MiFID Regulations came into effect on 1 November 2007.

Best Execution Regulations under MiFID

The best execution regulations under MiFID are set out in the following regulations:

- Regulation 97 – Best Execution
- Regulation 98 – Investment firm to act in clients' best interests
- Regulation 106 – Obligation to take all reasonable steps to execute orders on terms most favourable to the client

Client Categorisation

The MiFID Regulations set out a three-tier categorisation system classifying parties as retail clients, professional clients or eligible counterparties. The MiFID Regulations attach different levels of regulatory protection and approaches to each party depending on the category of client, with retail clients receiving the highest level of MiFID protection.

CESR

The Committee of European Securities Regulators (CESR) was the predecessor of the European Securities and Markets Authority (ESMA).

CESR was established in 2001. Its role was to improve co-ordination between securities regulators, to act as an advisory group to assist the EU Commission and to work to ensure more consistent and timely day-to-day implementation of Community legislation in the Member States.

ESMA is an independent EU Authority which was created on 1 January 2011. ESMA contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection.
http://www.esma.europa.eu/