MiFID II

Best execution
MiFID II planning and implementation is a top priority for asset managers affected by European regulations and brings with it both challenges and opportunities.

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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<tbody>
<tr>
<td>2007</td>
<td>MiFID in force</td>
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<td>2011</td>
<td>Proposal for MiFID II</td>
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<tr>
<td>2014-2015</td>
<td>ESMA consults on implementation</td>
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<tr>
<td>2016</td>
<td>MiFID II application delay confirmed</td>
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<tr>
<td>3 July 2017</td>
<td>Deadline for incorporation of MiFID II into EU Member State national law</td>
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<td>3 January 2018</td>
<td>MiFID II and MiFIR apply</td>
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Firms will be familiar with the requirement to seek best execution and to have and comply with an order execution policy under existing MiFID rules. MiFID II builds on these requirements, with certain key changes set out below.

Firms should consider how these requirements will affect their business, policies and procedures. In particular, a gap analysis of the firm’s existing order execution policy against the new requirements, together with an assessment of how to monitor and disclose the new disclosure requirements should be undertaken.

Key changes from MiFID

Firms will be familiar with the requirement to seek best execution and to have and comply with an order execution policy under existing MiFID rules. MiFID II builds on these requirements, with certain key changes set out below.

Requirement to take ‘all sufficient steps’

MiFID II enhances the MiFID requirement from taking ‘reasonable steps’ to seek best execution to taking ‘sufficient steps’. This is expected to involve strengthening front-office accountability and systems and controls to identify any potential deficiencies. Firms will need to monitor not only the execution quality obtained but also the quality and appropriateness of their execution arrangements and policies on an ex-ante and ex-post basis to identify circumstances under which changes may be appropriate.
Enhanced execution policy requirements

MiFID II introduces enhanced requirements for a firm’s execution policy.

In particular, there are new content requirements, including the requirement to customise the policy by class of financial instrument and further requirements in relation to inducements. There is also an overarching requirement that the policy must be clear and sufficiently detailed as in the regulator’s view this has often not been the case in the past.

Given that policies are likely to become longer and more specific, firms should also consider how this will affect their offering and other fund documentation, noting that the changes are likely to increase the risk of inadvertently making a misrepresentation or misstatement with respect to their policy.

Where a client is invited to choose the execution venue used, the firm must provide the client with fair, clear and not misleading information so that price is not the only factor considered by the client.

Where a client makes a reasonable and proportionate request for information about policies or arrangements or how they are reviewed, it is now a requirement (rather than just good practice and effective management of investor relations) that the firm must answer clearly and within a reasonable time.

Best execution monitoring will be required to take account of best execution data published by other MiFID firms and execution venues under the new MiFID II rules.

Where a firm has retail clients, it will also need to create a summary of its order execution policy, focusing on the total costs incurred relating to execution. This summary must include a link to the firm’s most recent published data on execution quality (as described below).

When executing OTC trades the firm must check the fairness of prices proposed to it by gathering market data used in estimating the price of the product and, where possible, by comparing such prices with similar or comparable products.

Publication of top five venues

A brand new requirement on investment firms under MiFID II is that firms that execute client orders will be required to publish annually for each class of financial instrument the top five execution venues by trading volume they use for execution purposes. This information will need to be presented in accordance with the templates provided in the regulatory technical standards published by the European Commission. The firm will need to disclose potentially sensitive data such as: (i) the volume of client orders executed on that venue as a percentage of its total executed volume for that class; (ii) number of client orders executed on that venue as a percentage of its total orders of that class; (iii) the percentage of executed orders that were passive (i.e. orders that provided liquidity) and aggressive (i.e. orders that took liquidity); and (iv) the percentage of orders where the client specified the venue in advance.

Firms that use other firms for order execution must publish a similar annual disclosure identifying each class of financial instrument for the top five firms so used and information on the quality of execution must be consistent with the publication requirements for direct execution.

For each class of financial instruments, the firm will also need to publish a summary of the analysis and conclusions it draws from its detailed monitoring of execution quality obtained in the previous year, including relative importance of execution factors, a description of any close links or conflicts of interest that might affect its execution process, any special financial arrangements with execution venues, an explanation of any change in its list of execution venues, how order execution differs according to client categorisation, whether other criteria were given precedence over immediate price and cost when executing retail client orders, how the firm has used any data or tools relating to the quality of execution, including any data published under the MiFID publication requirements, and how the firm has used the output of any consolidated tape provider established under MiFID.

What’s next?

Firms should consider how these requirements will affect their business, policies and procedures. In particular, a gap analysis of the firm’s existing order execution policy against the new requirements, together with an assessment of how to monitor and disclose the new disclosure requirements should be undertaken.