ESMA_QA_1016

Submission Date
10/10/2016

Status: Answer Published

Additional Information

Level 1 Regulation
Markets in Financial Instruments Directive II (MiFID II) Directive 2014/65/EU- Investor Protection and Intermediaries

Topic
Best Execution

Subject Matter
Best Execution

Question
How should firms and competent authorities understand the difference between “reasonable steps” and “sufficient steps”?

ESMA Answer

10-10-2016

Original language

[ESMA35-43-349 MiFID Investor Protection Q&A 1]

MiFID I required firms to “take all reasonable steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order”. MiFID II now instead requires firms to “take all sufficient steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order”.

Whilst firms remain subject to the same overarching obligation to obtain the best possible results on a consistent basis when executing client orders, the requirement for “sufficient” steps sets a higher bar for compliance than “reasonable” steps.

When designing their execution policies and establishing their execution arrangements, firms will have to ensure that the intended outcomes can be successfully achieved on an on-going basis. This is likely to involve the strengthening of front-office accountability and systems and controls according to which firms will ensure that their detection capabilities are able to identify any potential deficiencies. This will require firms 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. An example of ex-ante monitoring would be to ensure that the design and review process of policies is appropriate and takes into account new services or products offered by the firms. Accordingly, an ex-post monitoring may be to check whether the firm has correctly applied its execution policy and if client instructions and preferences are effectively passed along the entire execution chain when using smart orders routers or any other means of execution.

Firms’ processes might involve some combination of front office and compliance monitoring and could use systems that rely on random sampling or exception reporting.

There should be channels in place to ensure that the results of ongoing execution monitoring are escalated to senior management and/or relevant committees, and fed back into execution policies and arrangements to drive improvements in the firm’s processes.

This overarching requirement should not be interpreted to mean that a firm must obtain the best possible results for its clients on every single occasion. Rather, firms will need to verify on an on-going basis that their execution arrangements work well throughout the different stages of the order execution process. ESMA expects firms to take all appropriate remedial actions if any deficiencies are detected so that they can properly demonstrate that they have taken “all sufficient steps” to achieve the best possible results for their clients.