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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

What is meant by checking the fairness of the price proposed to the client when executing orders or decisions to deal in OTC products?

10-10-2016

Original language

MiFID II strengthens the existing best execution standard in relation to OTC¹⁰ products¹. In this regard, Article 64 of the MiFID II Delegated Regulation requires firms to check the fairness of the price proposed to the client when executing orders or taking decisions to deal in OTC products, including bespoke products, by gathering market data used in the estimation of the price of such products and, where possible, by comparing with similar or comparable products.

Firms, as a matter of practice, may be routinely taking account of external market data and externally verifiable reference prices (where available), when pricing or checking the price of OTC products (including bespoke instruments), in fulfilling their best execution obligations. However, MiFID II now imposes an explicit requirement on firms to ensure that such checks are undertaken on a systematic basis and embedded in their policies and practices. As a consequence, firms need to ensure that they have the necessary procedures and arrangements in place as well as appropriate valuation systems. With greater access to technology and data analytics, firms will be expected to scrutinise the methodologies and inputs underpinning any valuation processes and pricing models utilised with respect to OTC products in order to ensure that they are consistently checking the fairness of the price. Similarly, when placing orders resulting from decisions to deal in OTC products, firms will be expected to undertake the necessary checks on the fairness of the price and ensure that it is reflected in their arrangements.

This is an ex-ante assessment by the firm that takes place prior to the execution of the order. However, there is an expectation that any pre-trade checks or processes would be included in the firm's review and monitoring of its best execution arrangements. Firms would therefore need to have records, documentation in place, to evidence this as part of their ongoing monitoring of best execution.

The aim is for firms to be able to justify their pricing decisions, and have systems in place to ensure that any judgements or decisions are taken with the clients' best interests in mind and are not biased by conflicts of interest.

We expect that any checks or controls will be calibrated according to the nature of the financial instrument and the characteristics and circumstances of the individual trade.

1. For the purposes of this Q&A, a financial instrument is an Over The Counter or OTC product when it is: (i) not admitted to trading, or, (ii) not traded on a trading venue (i.e. a regulated market, an MTF or OTF).