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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

Where firms use a single venue, how can they evidence that this has allowed them to obtain best execution?

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Original language

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MIFID II does not prohibit firms from selecting only one execution venue to execute client orders in a given class of financial instruments where they are able to demonstrate that such a choice enables them to consistently get the best results for their clients. Since MiFID I was implemented there has been a sharp proliferation of execution venues leading to an increased fragmentation of the market. ESMA expects firms to be aware of the evolving competitive landscape in the market for execution venues operators and therefore to take into consideration the emergence of new players, new venues functionalities or execution services to determine whether or not any of these factors would support to include only one execution venue in their execution policy.

In order to comply with the requirement under Article 24(1) of MiFID II to act in the best interests of its clients, firms will need to regularly assess the market landscape to determine whether or not there are alternative venues that they could use. This assessment will benefit from the new metrics available under RTS 27^[1] and from any other relevant source of data. In particular, the reports generated pursuant to that RTS shall give firms information on trading conditions and quality of execution across different execution venues through a series of metrics such as volume, frequency of trading, resilience or execution price related information. The MIFID II Delegated Regulation sets out specific requirements relating to the content of the execution policy. According to this, firms have to include a list of the venues that the firm ordinarily uses, as well as a list of the quantitative and qualitative factors used to select the execution venues on that list.

Such an exercise involves a number of different actions. Specific analysis must be carried out to determine whether or not other suitable venues exist. In doing so, a firm may, for instance, benchmark the value of expected aggregate price improvements by adding a venue and comparing the expected outcomes against an assessment of any additional direct, indirect or implicit costs (to the extent that such costs would be directly or indirectly passed on to

clients), counterparty or operational risks.

Finally, using a single venue should not lead firms to be “over-reliant” on the single venue. Using a single venue does not diminish a firm’s responsibility to monitor the quality of execution. Nor does it mean that merely executing client orders on that venue will allow the firm to discharge its best execution obligations. When using only a single venue, the specific way that the firm executes the order may be just as important in achieving best execution. Indeed, sending an order to be executed on the central order book using different order types (e.g. limit orders, fill or kill ‘FOK’, peg order, good till cancelled ‘GTC’), executing the order using a pre-trade waiver, or executing the order at a closing or opening auction may result in materially different outcomes. Different outcomes may also stem from the way in which Smart Order Routers and/or algorithms are calibrated. Similarly, entering an order in one block, versus splitting it into multiple child orders, may have a very different market impact and thus directly affect the cost to the client.

Also, in order to comply with the requirement under Article 24(1) to act in the best interests of its clients, a firm should consider transmitting client orders instead of executing them itself where that would deliver a better result for clients, provided the firm is authorised for reception and transmission of such orders.

Similar analysis and assessments should be undertaken by portfolio managers or receivers and transmitters of orders that intend to send orders to a single entity for execution.

[1] RTS 27 refers to the regulatory technical standards under Article 27(10)(a) of MiFID II adopted by the EC on 08/06/2016, Commission Delegated Regulation (EU) 2017/575