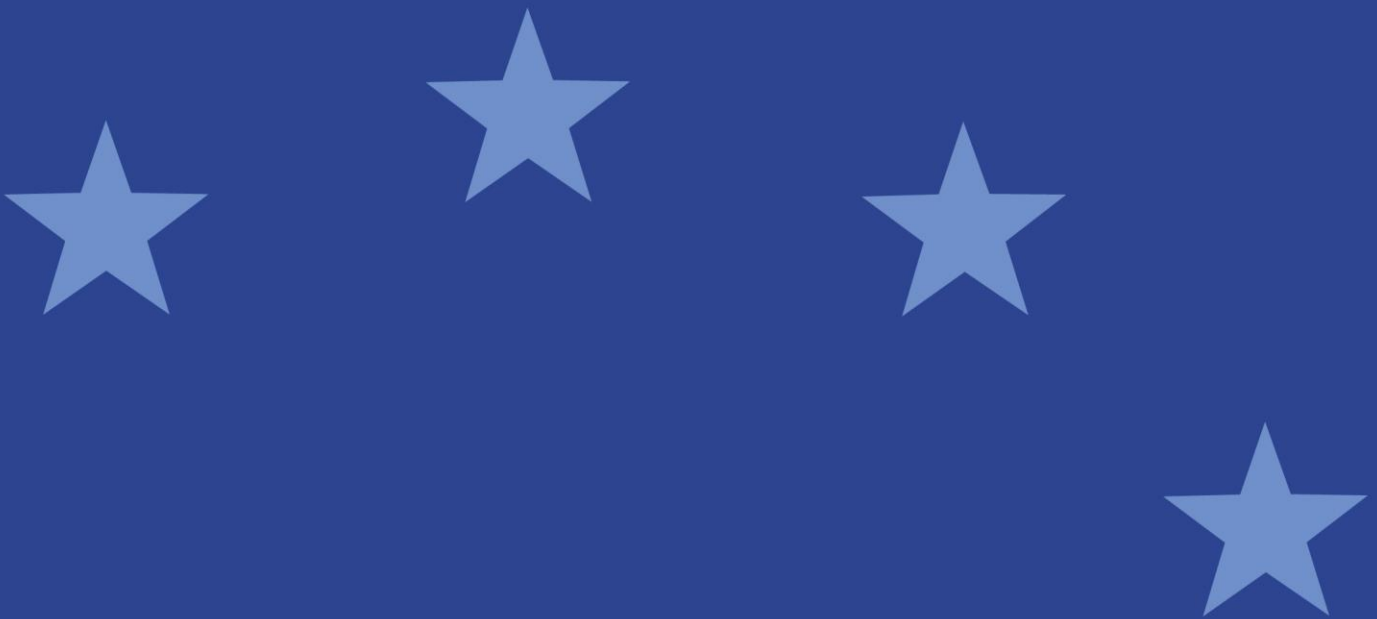




European Securities and  
Markets Authority

# Best Execution under MiFID

Peer Review Report



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## 1 – Introduction

1. In May 2013, the ESMA Board of Supervisors mandated the Review Panel to carry out a peer review regarding the obligation to execute orders on terms most favorable to the client (best execution) under article 21 of MiFID and its implementing provisions.
2. The work is intended to investigate how the EEA national competent authorities, who are represented in the ESMA Review Panel, nationally undertake their tasks with regard to the supervision and enforcement of the MiFID provisions on best execution.
3. The peer review is conducted in two phases: the first phase is the self-assessment in which Review Panel members answered a number of questions on the supervision and enforcement of the various dimensions of the best execution rules that have been developed against a set of key issues and benchmarks. The second stage is the peer review assessment which involves each Member's self-assessment being reviewed by peers on a desk-based basis.
4. The self -assessment questionnaire, which is enclosed under Annex 1, was launched on 9th August 2013 and the timeline for Members to provide the responses to the questionnaire including the provision of supporting evidence was 20th September 2013<sup>1</sup>.
5. On November 2013, ESMA staff collected from Review Panel members additional information. Moreover, members were asked to provide a number of clarifications and additional descriptions and evidence supporting their responses.
6. The peer review was complemented by an on-site visit program which constituted an additional and integral part of ESMA's process of analyzing the approaches developed by the CAs to supervise compliance with best execution requirements. The purpose of the on-site visits was to learn more about the practices and supervisory tools used by the selected Competent Authorities (CAs): AMF, France; CNMV, Spain; CSSF, Luxembourg; FMA, Liechtenstein; KNF, Poland and MFSA, Malta, and to reveal potential difficulties in the implementation of key issues under review.
7. The information gathered in the course of the self-assessment has been reviewed by peers taking into account the written evidence provided by the CAs and, in relation to those CAs subject to on-site visits, the information provided on this occasion.
8. This report sets out the outcome of this assessment and describes the degree of convergence in supervisory and enforcement practices across the EU in relation to the various dimensions of the best execution rule.
9. All Review Panel members, except Iceland, contributed to this peer review. The country codes and acronyms of CAs are listed in the following tables.

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<sup>1</sup> The types of evidence which could be provided include all information described in para. 6.1 of the Decision of ESMA establishing its Review Panel (ESMA/2011/BS/229) in force at the time of the launch of the questionnaire (and not limited to the indicative list in the appendix to the methodology, see ESMA/2012/33).

10. The review period is from 1 January 2011 to 31 December 2012. The on-site visits at AMF, CNMV, CSSF, FMA, KNF and MFSA took place between 9 June 2014 and 1 August 2014.

**Table 1:** Country codes and acronyms of Competent Authorities (CAs) participating in the ESMA survey

<b>AT</b>	Austria	Finanzmarktaufsicht	FMA
<b>BE</b>	Belgium	Financial Services and Markets Authority	FSMA
<b>BG</b>	Bulgaria	Financial Supervision Commission	FSC
<b>CY</b>	Cyprus	Cyprus Securities and Exchanges Commission	CySEC
<b>CZ</b>	Czech Republic	Czech National Bank	CNB
<b>DE</b>	Germany	Bundesanstalt für Finanzdienstleistungsaufsicht	BaFin
<b>DK</b>	Denmark	Finanstilsynet	Finanstilsynet
<b>EE</b>	Estonia	Estonian Financial Supervision Authority	EFSA
<b>EL</b>	Greece	Hellenic Capital Market Commission	HCMC
<b>FI</b>	Finland	Finanssivalvonta	FIN-FSA
<b>HU</b>	Hungary	Magyar Nemzeti Bank <sup>2</sup>	MNB
<b>IE</b>	Ireland	Central Bank of Ireland	CBol
<b>IT</b>	Italy	Commissione Nazionale per le Società e la Borsa	Consob
<b>LT</b>	Lithuania	Lietuvos Bankas	LB
<b>LV</b>	Latvia	Financial and Capital Markets Commission	FCMC
<b>NL</b>	Netherlands	Autoriteit Financiële Markten	AFM
<b>NO</b>	Norway	Finanstilsynet	Finanstilsynet
<b>PT</b>	Portugal	Comissão do Mercado de Valores Mobiliários	CMVM
<b>RO</b>	Romania	Financial Supervision Authority	FSA
<b>SE</b>	Sweden	Finansinspektionen	Finansinspektionen
<b>SI</b>	Slovenia	Securities Market Agency	SMA
<b>SK</b>	Slovakia	National Bank of Slovakia	NBS
<b>UK</b>	United Kingdom	Financial Conduct Authority	FCA

<sup>2</sup> The 'Best Execution Survey' was originally answered by the Hungarian Financial Supervisory Authority (HFSA), however on 1 October 2013, HFSA has been merged into Magyar Nemzeti Bank (MNB).

**Table 2:** Country codes and acronyms of on-site visited Competent Authorities

<b>ES</b>	Spain	Comision Nacional del Mercado de Valores	CNMV
<b>FR</b>	France	Autorité des Marchés Financiers	AMF
<b>LI</b>	Liechtenstein	Finanzmarktaufsicht	FMA
<b>LU</b>	Luxembourg	Commission de Surveillance du Secteur Financier	CSSF
<b>MT</b>	Malta	Malta Financial Services Authority	MFSA
<b>PL</b>	Poland	Polish Financial Supervision Authority	KNF

**Table 3:** Country code and acronym of Competent Authority not participating in the ESMA survey

<b>IS</b>	Iceland	Financial Supervisory Authority	FME
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## 2 – Executive Summary

11. MiFID1 abolished the concentration rule (i.e. the possibility to direct preferably retail orders to the regulated market if certain conditions<sup>3</sup> were met, still allowed by ISD 22/1993/EC) introducing a set of principles and rules on best execution. The rules of the MiFID were supplemented by level 2 measures (Article 44 of the Commission directive 2006/73) detailing the criteria<sup>4</sup> investment firms should take into account when executing client orders to obtain the best possible result for their clients.
12. The objective of the regulation was to create an environment where trading venues and executing venues were supposed to fully compete among each other and investors (in particular retail investors) to obtain the best execution (in terms of price, cost, speed, likelihood of execution and settlement, size, nature or any other considerations relevant to the execution of the order). Such provisions appear as a subset of the broader chapter dealing with order execution (which includes client orders handling rules and obligations relating to investment firms that transmit or place orders to other firms for execution).
13. The approach followed by MiFID1 will be basically confirmed by MiFID2 which does not set out major changes to the best execution requirements and no real remarks were made in the negotiations under this chapter except in terms of enhancing the information given to clients on their execution policy and providing information about the venues where their orders are sent for execution.
14. This peer review allows a first assessment on whether the intended increase in competition as envisaged by MiFID1 in order to benefit retail investors was implemented and enforced by the national regulators under the best execution obligations. The value of this report is increased by the fact that a number of authorities were visited on site (AMF, France; CNMV, Spain; CSSF, Luxembourg; FMA, Liechtenstein; KNF, Poland; MFSA, Malta<sup>5</sup>). This allowed the assessors to discuss in detail the issues that emerged already from the responses to the basic questionnaire and specifically the low level of activity devoted to monitoring the best execution as well as the low level of understanding by investors (probably testified by the low level of complaints) of such provisions.
15. The majority of authorities which were subject to this Peer Review appear still to use the execution of shares (probably the most liquid market) on the relevant domestic market as a good proxy for the assessment of best execution. In one case, it appears that national legislation favours the execution of orders on the domestic market and, in effect, exempts investment firms from searching for the best execution.
16. The best execution of orders invariably seems to be interpreted in terms of best price and not with regard to the analysis of the other execution factors, even in markets for which there is a certain level of dispersion and where several execution venues exist. Mostly, the CAs limit their supervisory approach to verifying whether an execution policy exists (this is verified at the moment of authorisation or in the course of on-site visits/inspections) and contains the information required under MiFID1. There appears to be little rigorous scrutiny as to whether these policies are tailored to the class of

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<sup>3</sup> See Article 14 of ISD

<sup>4</sup> For determining the relative importance of the factors to be considered set forth under article 21 of MiFID

<sup>5</sup> Autorité des Marchés Financiers - AMF, France; Comisión Nacional del Mercado de Valores – CNMV, Spain; Commission de Surveillance du Secteur Financier – CSSF, Luxembourg; Financial Market Authority – FMA, Liechtenstein; Komisja Nadzoru Finansowego – KNF, Poland; Malta Financial Services Authority – MFSA, Malta

instrument or venue type to which the orders are sent for execution. In certain cases, limited additional checks were carried out when problems emerged in relation to client order execution.

17. The discussions, particularly with the CAs visited, demonstrate that this lack of comprehensive supervision could also be due to the lack of easily available information on the price of the orders executed at the various venues. Even where this price information exists, CAs commented that it is a significant undertaking for them to analyse this information to determine execution quality. In other words, the lack of a European “consolidated tape” (or better consolidation of information on prices on the different venues) seems to be an issue when it comes to the monitoring of best execution and even when sample of transactions are reviewed the proxy market approach is still necessary. In a number of cases the CAs argued that the level of dispersion is very low and therefore there is no need to compare execution quality between venues. Other CAs declared that there are no alternative execution venues to the domestic market. Moreover, all the CAs seem to disregard that investors might wish to invest in securities which are not listed in the domestic market or are foreign securities. As a result it seems that there is no real assessment of whether orders should have been executed outside their national markets.
18. It also seems that the best execution is deemed to be relevant mainly to shares rather than to bonds. Even where regulated markets exist for bonds the relevant authority declared that the trading on the regulated market is irrelevant and the secondary market is made by large bond dealers (normally international banks). In such cases information on the conditions for the trades is sometimes provided by data providers such as e.g. Bloomberg. No real supervisory activity seems to be performed by the majority of the participants to the survey on this “instrument class” in terms of best execution - even where it was demonstrated that there were issues on the prices provided by the banks (which revealed that there was general inaccuracy in the information provided to clients in the order execution policy).
19. It also emerged that in case of an international group a number of local subsidiaries/branches route the orders to an entity in the group specialising in execution services this is accepted by default as the best firm for executing the orders of the group’s clients. Given the limitations of the peer review the assessors did not discuss in detail the implications for clients, not only in terms of the execution price given but also in terms of the fees paid by clients for the service provided and their impact on the overall quality of execution – which would be of special relevance for retail client orders. The issue of the selection of the execution venue is particularly relevant in the case of the asset management service where the issue of inducements (execution venue selected because they provide research services) is important and which can ultimately impact on the execution quality given to their clients.
20. The level of complaints in the sector is low. This can likely be attributed to the low level of understanding of execution quality amongst investors as well as to a certain “opacity” of the best execution practices followed by the firms. The fact that several supervisory systems seem to be very ‘reactive’ in approach and heavily reliant on complaints before a further investigation is triggered, could also explain the low level of enforcement in this sector.
21. The review also points out that structural issues make it difficult to deliver the outcome that MiFID 1 intended to deliver in terms of benefits for the retail investors. There is the issue of the absence of a consolidated system of information on the prices but there are also cases where alternative competitive venues have not developed. This could also be due to an implementation which favours by law or by practice (not necessarily of the CAs but also of the industry) a concentration in the

domestic market. In certain cases, this could also be due to the lack of interest or the perceived costs associated with setting up alternative venues for certain financial instruments. The issue of the ability of the alternative venues to be price makers should also be discussed and analysed further since a number of visited CAs maintained (producing some studies) that the MTFs which deal in their domestic stocks are simply price takers and they do not trade when the main market suffers disruptions which halt trading for a certain time period.

22. The issue, particularly for 'low liquid shares', of concentrating liquidity on a single venue as a means for providing best price and best execution quality was also raised in the course of the conversations with the assessors.
23. Implementation of MiFID2 could help in solving certain shortcomings identified within these CAs, however it seems that a more in-depth reflection on the implementation, supervision and enforcement of the best execution rules and how to deliver the best service for investors is necessary.
24. Summing up, the assessors feel that a number of recommendations could be made for CAs and ESMA for ensuring a better implementation, supervision and enforcement of the rules on best execution. A list of possible actions could include:
  - Providing guidance for the national implementation of MiFID provisions concerning best execution, in order to ensure a common understanding on the scope and obligations set forth by such provisions;
  - Assessing the adequacy of internal resources devoted by the CAs to the supervision of best execution;
  - Assessing the frequency and intensity of CAs' active monitoring in the area of best execution, which should be a combination of desk-based and onsite reviews, prompted by the employment of a variety of information sources and encompassing all aspects of best execution. Benchmarks for review could include whether periodic reporting by firms is required in this respect, and whether specific use of thematic reviews, client complaints and order execution analysis/order transaction analysis is taking place;
  - Providing guidance in order to ensure the development by the CAs of clear internal processes or practices identifying the controls to be conducted when a firm has only one execution venue listed in its execution policy for a particular type of financial instrument;
  - Developing specific consumer education programs;
  - Assessing whether specific obstacles exist to the development of alternative execution venues; and
  - Assessing the frequent and consistent use of proportionate sanctions (with sufficiently high financial penalties) to ensure a credible deterrent effect against future breaches.



## 3 – Peer review assessment

### 3.1 - Overview

25. The findings of this desk-based peer review are organized in six sections mirroring the key issues identified in the questionnaire.
26. Section A is devoted to a description of the main institutional and market related background, including the number of firms and size of the market.
27. Section B is focused on the organization and supervisory approach CAs endorse in the general supervision and enforcement of best execution and the relevant main tools.
28. Sections C to F are devoted to the way the various dimensions of the best execution provisions are specifically supervised. These Sections have been developed taking into account the existing set of ESMA guidance relevant for this topic, and particularly the MiFID Supervisory Briefings – Best Execution (Ref. CESR/08-735) and ESMA Q&A on Best Execution under MiFID of May 2007 (Ref. CESR/07-320).
29. In summary, from the written information received in the course of this desk-based peer review, it appears that CAs apply a variety of different approaches.
30. In terms of market size as of 31 December 2013, indeed, most of investment firms and credit institutions subject to the best execution rule are located in UK (4,143), followed by DE (2,485), FR (956), AT (802), IT (786), ES (516), and FI (323). A range of firms between 300 and 150 are based in LU (285), NL (274), CY (191), DK (187), IE (172), and NO (150); a range between 149 and 50 are based in BE (132), LI (1), EL (103), SE (99), BG (78), PL (71), CZ (64), PT (58), RO (58) and MT (53); a range of firms lower than 49 are based in HU (48), LV (41), LT (36), SK (29), EE (27), and SI (19).
31. As regards organization, in all CAs the supervision of best execution is part of the general MiFID conduct of business supervision and the general approach and resources to supervise compliance with such provisions do not differ from those applied in the supervision of MiFID conduct of business rules. In particular, in most CAs<sup>6</sup> more than one unit is involved in the supervision of MiFID provisions, including best execution, while in some CAs<sup>7</sup> the supervisory function is carried out by one unit. However, in few instances, the resources allocated to the supervision of best execution are so limited (in terms of the relation between resources/ firms to be supervised/ scope of supervision) that the CAs' ongoing proactive monitoring of best execution appears limited and mainly performed in reaction to complaints or other alerts from external sources.
32. The use of databases, even though differing on the basis of the relevant level of sophistication<sup>8</sup>,

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<sup>6</sup> AT, BE, CY, CZ, DE, DK, ES, FI, FR, HU, IE, IT, LI, LU, LT, LV, NL, NO, RO, SE, UK

<sup>7</sup> BG, EL, MT, NO, PL, PT, SI, SK

<sup>8</sup> For instance, only 15 CAs (BE, BG, DE, FI, FR, HU, IE, IT, LI, NO, PT, SE, SI, SK, UK) developed at least one integrated database including information and intelligence on best execution, which combines data received by various sources. Other CAs hold a number of separate databases (AT, CZ, LU, LV, NL), or only one database with information limited to one main source (CY, EL, ES, RO, HU). In MT, the CA has not established any database. In PL, the CA saves documents and information in a "cloud system".

allows the internal sharing and processing of some intelligence or other sources supporting supervision of best execution.

33. To a certain extent, these different organisational arrangements seem to reflect the different dimensions of the local markets and of the CAs.
34. Similarly, there is a variety of supervisory approaches which are applied by the CAs in relation to the particular area of best execution requirements. In most of the cases<sup>9</sup>, CAs employ mainly or partly a risk based supervision, although a variety of different practices exists. In particular, a number of CAs (see relevant details under Section B below) should strengthen their supervisory approach in order to develop clearly defined qualitative and quantitative criteria setting out when and how the CAs should undertake supervisory actions and how they determine the main points of emphasis underlying such actions. In fact, it appears that such CAs do not employ one or more of the minimum factors established in the key issues under Section B of the self-assessment questionnaire, or, where such factors are employed, it is unclear how they are used and the extent to which they are able to trigger supervisory actions by the CAs in relation to best execution issues.
35. Moreover, some differences are detected in the provision and employment of periodic reporting by supervised entities as a supervisory tool to get additional intelligence on how supervised entities comply with their obligations concerning best execution. In this regard, it seems that not all the CAs have established specific information/reports to be sent on a periodic and regular basis by the supervised entities in order to assess compliance with best execution requirements<sup>10</sup>.
36. It is also observed that some CAs<sup>11</sup> endorse a two pillar approach in the supervision of best execution whereby there is reliance on the supervisory outcomes of external audit firms<sup>12</sup> which report on an annual basis at the time of the release of the certification on the annual accounts also the outcome of the checks performed to verify MiFID compliance (including conduct of business rules). In some instances, this approach allows for the desk-based review of all firms within a year cycle. It could suffer, however, of limitations due to multiple sampling and outsourcing public supervision to private firms. The level of reliance of the CAs on these reports as well as their combination with other tools of direct supervision seem also to vary from one CA to another.
37. The review also shows that the monitoring of compliance to best execution requirements varies among the CAs according to the relevant intensity and coverage of desk-based reviews<sup>13</sup>, and

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<sup>9</sup> AT, BE, CY, CZ, DE, EE, EL, ES, IE, FI, FR, IT, LI, LU, LV, MT, NL, NO, PT, SE, SI, UK.

<sup>10</sup> For instance, in 3 cases (EE, EL, NL) the main source of reporting is firms' responses to ad hoc or periodic self-assessment questionnaires sent by the CAs. 6 CAs (AT, DE, ES, FR, LU, LV, NL) carry out desk based reviews related to best execution at least on a yearly basis. In EE self-assessment questionnaires are sent to firms once every 3 years. In 3 CAs (BE, CZ, IT) desk-based reviews are carried out on an ongoing basis, e.g.: following the receipt of information in accordance with periodic and "timely" reporting obligations on all firms (i.e.: the reporting shall take place every time a material change occurs). In LI, it seems that the CA relies on the checks performed at the time of the authorisation and on the outcomes of auditors' reports, while additional sources of information, such as reporting by supervised entities, are not used.

<sup>11</sup> AT, DE, LI, LU, MT.

<sup>12</sup> In these cases, more active and in-depth analysis is carried out by CAs mainly where particular deficiencies or weaknesses emerge from those reports.

<sup>13</sup> For instance, in few CAs (BE, DE, FR, IT, LU, LI), the intensity of the review of information varies depending on the risk ranking given to the firm. In 4 CAs (IE, LV, NL, UK), not only the intensity, but also the coverage and frequency of the reviews vary depend-

frequency, duration and scope of on-site inspections<sup>14</sup> carried out by the CA and in relation to the reliance by the CAs on one or both above-mentioned tools<sup>15</sup>. Thematic reviews<sup>16</sup> and face-to-face meetings with firms' management<sup>17</sup> are also employed to a varying extent by the CAs.

38. However, desk based supervision focused on best execution seems to be limited (often the CAs referred to the reading of the annual report from the compliance function as the desk based review). More than half of the CAs should strengthen their ability to actively monitor best execution on a desk-based basis (see table in paragraph 50) and in few cases<sup>18</sup>, no regular desk based reviews are carried out in the supervision of best execution. In some instances, it seems that supervision of best execution mostly takes place at the initial stage of authorization of the investment firm and only to a limited extent afterwards.
39. Also another common finding emerging from the peer review is that most CAs have not put in place a process or a practice to monitor the outcomes of their supervisory and enforcement actions and to improve their approach accordingly. This lack of dynamic reviews and evolving approach may affect the ability to timely react to changes in market practices and to new emerging risks.
40. Additional efforts are needed in the supervision of firms' best execution arrangements and policies, where a number of CAs would appear not to apply sufficient standards. A number of shortcomings have been detected also in other areas of supervision (see table in par. 3.3 below).
41. The peer review reveals considerable variation in the way that CAs supervise whether a 'material change' has triggered a review of firms' execution policies and arrangements outside of the regular annual review. Particularly, some CAs concentrate on annual reviews of execution policy, not giving much consideration to "material changes" that could prompt an additional review.
42. Indeed, the majority of CAs did not provide detailed information on differences in relation to the way they supervise the various classes of financial instruments subject to best execution. Nevertheless,

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ing on the risk assessment of the firm. It should be noted that while in UK there is a periodic cycle of reporting applying also to smaller firms.

<sup>14</sup> For instance, 4 CAs (HU, RO, SI, SK) review every investment firms according to an inspection cycle lasting from two to five years. Other (21) CAs (BG, BE, CY, CZ, DE, EE, EL, ES, FI, FR, IE, IT, LT, LU, LV, MT, NL, NO, PT, SE, UK) select the investment firms subject to on-site visits according to pre-defined (usually risk based) criteria. As regards the scope, 12 CAs (DE, ES, HU, IT, LU, LV, LT, NO, PT, SE, SI, UK) usually perform broad on site visits covering reviews of compliance to all MiFID provisions, whilst in others (AT, BE, CY, FI, FR) usually make a selection of the subject matters to be reviewed. In some cases (BG, CZ, EL, MT) both approaches equally apply. Only some (BG, CZ, DE, ES, FI, FR, IT, LI, LU, SE, UK) CAs have established a clear process to determine when non-routine inspections should be performed. In LI, onsite inspections are mainly performed in the authorisation phase, while subsequent visit would be typically event-driven. In PL, it is not clear whether the CA employs any criteria for prioritising onsite inspections to particular firms or types of firms, the level of frequency and the intensity of the engagement that is applied in each case.

<sup>15</sup> In most of the CAs, the approach employed for the supervision of best execution equally includes both desk-based and on-site reviews, whilst in others (BG, DK, EL, ES, FI, HU, NO, PT, SI) the main tool is on-site inspection

<sup>16</sup> For instance, in 16 CAs (BE, CY, CZ, DE, DE, DK, FI, FR, HU, IE, IT, NL, NO, SE, SI, UK) thematic works are used broadly to assess common practises and emerging risks as well as the level of compliance of firms to a particular set of provisions or the reaction to new regulatory initiatives or other developments, while in EL thematic works are used for more limited purposes, for instance as a mean to request firms to provide information which will be used to select firms for on-site inspections. In 2 CAs (BG, RO), thematic work has only been performed as thematic inspections and/or hearings.

<sup>17</sup> Whilst 19 CAs (AT, BE, CY, DE, DK, EE, FI, FR, IE, IT, LI, LT, LU, LV, NL, NO, PT, RO, UK) employ them on a routine basis as a general supervisory tool, others (BG, CZ, EL, HU) make use of them only in the course of on-site visits (e.g. to plan the visit, and/or to discuss findings) and/or when undertaking inspections or enforcement actions.

<sup>18</sup> BG, HU, PL, SE.

the challenges identified by some CAs suggest that supervision of best execution in relation to instruments with lower prices transparency, lack of standardised data and market fragmentation may be more difficult and underestimated.

### **3.2 - Conclusions**

43. The level of implementation of best execution provisions, as well the level of convergence in the general supervisory practices by CAs, is relatively low. More convergence has been detected where L3 measures specifically devoted to the supervision of best execution exist, although still a number of improvements may be introduced both at national level and within the EU framework in order to foster convergent outcomes and more effective enforcement actions.
44. Further efforts should be made in order to improve supervision of best execution across CAs and achieve additional convergence among Member States. Such efforts would benefit from an in-depth reflection on the rationale of best execution regulation and the manner in which it can be practically implemented in Europe.
45. As regards organization, CAs are encouraged to devote sufficient resources to deliver appropriate results and favour a proactive approach in their supervision. Moreover, the development and application of appropriate mechanisms to establish and review on a periodic basis their strategies and priorities, including on best execution, is suggested. IT systems could also be considered helpful in order to support supervision and enforcement by generating reports and alerts and identifying possible breaches.
46. Further efforts should be made by the CAs to give appropriate attention to best execution, which seems to be considered a low risk topic and is given limited priority and attention in the CAs' supervision regarding conduct of business requirements.
47. In particular, CAs should be able to demonstrate which criteria they use to supervise compliance with best execution and how these criteria are used in order to identify and assess relevant material risks and mitigating factors. Upon the occurrence of a triggering event, CAs should be able to assess and prioritize actions to address these risks.
48. Moreover, CAs should actively monitor compliance with best execution on a desk-based basis by employing a variety of information sources (including periodic reporting by supervised entities, market intelligence sources available to the CAs, investor complaints, etc.) and through onsite inspections carried out in accordance with a pro-active approach and not limited to cases where there is suspicion of irregularities. Such active monitoring should encompass all aspects of best execution. The supervisory methodology should cover all MiFID firms, but the coverage, frequency and intensity should be proportionate to the scope and scale of relevant activities and calibrated taking into account both investor protection and market integrity.
49. The assessment team also agreed on suggestions directed to the visited authorities with a view of improving convergence and making supervision of marketing communication and investor information more effective. A summary of the key suggestions is provided here below:

- AMF

Since best execution is not assessed by the AMF as a high risk topic and hence not considered as a core supervisory priority, on the basis of the specificities at play in their market, for which a retail end client is rarely in direct contact with the firm executing their order, the AMF seems to largely rely on the screening of the best execution policies and procedures performed at the time of authorisation and in case of changes of the firms' business models, while desk-based reviews and onsite inspections are particularly prompted by the RAC<sup>19</sup>, which is the report submitted by compliance officers on an annual basis. However, AMF carried out a thematic review and issued a communication on best execution and best selection. Placing more emphasis on best execution issues in the ongoing monitoring of firms, for instance by increasing the use of the tool of onsite inspections to supervise this area, by taking a sample of orders, and by conducting more rigorous transaction analysis on a more systematic basis, in combination and as a complement to the regular review of compliance function annual reports, could help in improving this system.

- CSSF

Overall the CSSF has established an adequate organisational structure for the supervision of investment firms and banks. However, limited attention is devoted by the CSSF to check directly whether the best possible result is achieved by firms executing orders. In particular, reliance is placed on the supervisory outcomes of external audit firms and more active and in-depth analysis is carried out by the CA mainly where particular deficiencies or weaknesses emerge from those reports. Improvements could be made by ensuring that the supervision on best execution is performed on an ongoing and continuous basis, for instance by raising its ranking among the triggering factors for direct supervision in addition to the routine audit reports. Use of thematic work could also be considered.

- CNMV

Although the CNMV has established a good organisational structure for the supervision of MiFID conduct of business rules, best execution is not a core priority in the supervision of the Spanish market due to the market concentration for most instruments and the non-relevant and low number of claims and other alarms. The bulk of the checks is performed in the course of general inspection even if they are performed and focused on procedural and information aspects. This system may benefit of additional attention to best execution issues, by further strengthening the intensity of the CA's supervisory actions and monitoring on best execution and the establishment of specific reporting requirements by supervised entities, in order to get additional intelligence on this issue.

- FMA

The FMA appears to be largely non-compliant particularly due to the best execution regime currently operating in Liechtenstein which seems to be largely based on the declared intention of the client to avail him or herself of a given execution venue (usually a bank) and largely non applied in the case of investment firms/asset managers. Where supervision on best execution is performed, it seems to be focused on checking the existence at the bank of the policy and the consistency of the content of the policy with respect to the MiFID requirements. The related checks are mostly performed during the

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<sup>19</sup> Rapport Annuel de Contrôle

authorisation process and subsequently by external auditors, which represent the first pillar of the “dualistic supervision” or two tier approach adopted by FMA. In light of the above, it is suggested that the FMA reconsiders its approach to MiFID implementation and is encouraged to strengthen its direct monitoring on MiFID requirements, in combination and as a complement to the regular review of audit reports in order to improve investor outcomes.

- KNF

The KNF does not apply the key issues set forth in this peer review particularly due to the practical non application of best execution requirements. It appears that only 0.11% of the orders intermediated in the Polish market are subject to best execution. This could also be linked to the existence of a specific provision in the Polish legal framework setting forth an exemption from the application of best execution requirements for investment firms which “receive and transmit orders in order to execute them in one place of order execution”. A similar exemption exists for firms that “execute orders only in one place of order execution”. Hence, even in relation to the limited number of firms not subject to the above exemption, supervision seems to take place on a very limited basis (as indicated only 0.11% of the orders). Moreover, the issue of execution of transactions in foreign financial instruments is scarcely considered. Therefore consideration should be given on further adapting the national regulatory framework to the MiFID requirements. The KNF should also reconsider their supervisory approach, and strengthen their active monitoring on best execution particularly by employing more tools for direct supervision, for example KNF should put in place reporting requirements by supervised entities more focused on the best execution issue and make more intensive use of on-site visits in this respect.

- MFSA

Best execution appears to be considered as a low priority topic by the MFSA which claims that due to local specificities either only one market exists or orders are routed to foreign intermediaries. Limited attention is therefore devoted by the MFSA to check directly whether the best possible result is achieved by firms executing orders, while some checks are performed to verify the existence of the policy, although in an indirect manner, since the CA endorses a two pillar approach whereby reliance is placed on the supervisory outcomes of external audit firms’ activities. Improvements could be made by ensuring that the supervision on such area is performed on an ongoing and continuous basis, and it is not limited to a formalistic check of the existence of the best execution policy, for instance by improving the CA’s tools for direct supervision, such as the analysis of actual transactions, the performance of independent focused on-site inspections and thematic reviews. In addition to this, in relation to the issue of client orders transmitted to firms other than Maltese investment firms for execution, the MFSA is encouraged to develop specific procedures, in order to ensure that the best possible result for clients is achieved also in these cases.

### **3.3 - Peer Review findings**

50. The main findings arising from the application of the criteria set forth in this peer review are summarised below:

51.

<b>ORGANISATION AND GENERAL APPROACH CONCERNING THE SUPERVISION OF BEST EXECUTION</b>	
<p><b>Application:</b> AT, BE, CZ, DE, ES, FI, FR, IE, IT, LU, NL, NO, PT, UK</p> <p><b>Partial application:</b> LV, MT, SI</p> <p><b>Insufficient application:</b> BG, CY, DK, EE, EL, HU, LI, LT, PL, RO, SE, SK</p>	
<p><b>B.1</b></p> <p><b>Clear internal communication of supervisory</b></p>	<p>In BG the CA asserts to have internal communication, but did not provide details on the means used to communicate their respective supervisory approach internally.</p>
<p><b>B.3</b></p> <p><b>Organisational structure, procedures and resources allowing appropriate supervision and enforcement</b></p>	<p>4 CAs have not been able to show that the supervision of best execution, is part of the CAs established organisational structure, procedures and resources:</p> <ul style="list-style-type: none"> <li>• in BG, the CA mentioned that the staff has to follow a handbook for inspections, but has not explained how staff is instructed to ensure appropriate supervision and enforcement where tools other than on site visits are employed;</li> <li>• in DK the CA has not so far systematically and routinely conducted supervisory activities focused on best execution; investigation on this topic have been merely <i>ad hoc</i>. The resources dedicated to it appear to be limited;</li> <li>• in MT, other than possible review through on-site visits, there are no clear predefined procedures for the supervision of best execution and no database has been established by the CA to support its activity in this regard. Moreover, it appears that best execution is not considered as a major concern in the Maltese market and therefore it is given low priority in MFSA's supervisory approach;</li> <li>• in PL, while overall the CA appears to have organisational arrangements for supervision of conduct of business and there are formal lines of communications between departments, it is not clear from the assessment how frequently this organisational structure is used in relation to best execution.</li> </ul>

<p><b>B.4</b></p> <p><b>Clear supervisory approach and relevant criteria, including</b></p> <p><b>(i) scale of activities or volume of investment products covered;</b></p> <p><b>(ii) volume of complaints and alerts received;</b></p> <p><b>(iii) indicators from the regular review of audit report or indicators from the review of information and data transmitted by investment firms;</b></p> <p><b>(iv) nature of complaints and alerts received;</b></p> <p><b>(v) type of products.</b></p>	<p>10 CAs have not been able or have been able to only show partially that they extensively apply the key issues set forth in this peer review as regards the supervisory approach. In particular:</p> <ul style="list-style-type: none"> <li>• two CAs (BG, PL) stated that they employ all the aforementioned factors, but have not provided sufficient evidence or explanations in this respect;</li> <li>• in EL, the CA seems to rely on factors (ii) and (iv) in the supervision of best execution, while the other factors are employed mainly for prudential supervision;</li> <li>• in ES, the CA's supervisory approach in relation to best execution mainly relies on onsite inspections, although some desk-based reviews are conducted on the basis of the compliance function's reports submitted on an annual basis to the CAs and on the basis of complaints;</li> <li>• in FR, the CA seems to largely rely on the screening of the best execution policies and procedures performed at the time of authorisation and in case of changes of the firms' business models. Desk-based reviews and onsite inspections are particularly prompted by the compliance function's annual report submitted on an annual basis to the CA;</li> <li>• one CA (RO) does not appear to make use of the "type of product" (factor under (v) above);</li> <li>• two CAs (LI, MT) appear to mostly rely on annual external audit reviews;</li> <li>• in one CA (LU), it seems that supervision is mostly carried out by the auditors and accounted for in the annual report auditors provided to the CA, although some checks may be performed in the course of broad-scope onsite inspections;</li> <li>• two CAs (DK, PL) do not appear to make use of indicators from the review of information and data transmitted by investment firms, nor of the regular review of audit reports (factor under (iii) above). The CA of DK also pointed out that the other factors are used indirectly and not in a systematic or formalised way;</li> <li>• in one CA (LI), there is a lack of clarity on what MiFID business/services asset management firms undertake/perform and this is combined with asset management firms not applying best execution requirements' ;</li> <li>• in PL, the supervisory approach of the CA is clearly influenced by the legal regime applicable in this jurisdiction, which provides for a legal exemption to implement best execution for firms receiving and transmitting orders and directly executing these orders in one place of order execution.</li> </ul>
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<p><b>B.5</b></p> <p><b>Active monitoring on a desk-based basis</b></p>	<p>In 14 CAs, active desk based monitoring of best execution does not take place extensively because:</p> <ul style="list-style-type: none"> <li>• the CAs desk based reviews do not include periodic reporting by firms or independent auditors (DK, EL, RO);</li> <li>• the CAs desk based reviews do not include information from other competent authorities, where available (DK, RO);</li> <li>• the CAs desk based reviews do not include any of the sources of information listed in the key issue relating to active desk based monitoring (DK, PL, SE);</li> <li>• the CAs perform active desk based reviews only on a very limited basis and mostly in connection with on-site inspections or limited information has been provided on the various desk-based information sources (BG, CY, EE, HU, LT, RO, SE, SK);</li> <li>• weaknesses are monitored mostly on the basis of external audit reports and, where available, customers complaints; in their desk-based reviews the CAs appear to place excessive reliance on external sources, without carrying out sufficient own analysis (LI, MT).</li> </ul>
<p><b>B.6</b></p> <p><b>Periodic and non-routine inspections.</b></p>	<p>In one CA (PL) the CA has not developed any criteria for prioritising onsite inspections.</p>
<p><b>B.8</b></p> <p><b>Thematic work</b></p>	<p>4 CAs (BG, EE, LV, PL) have not been able to show that they have established an approach to determine on what topics to undertake thematic work (whether or specifically on best execution), since they appear to make use only of other monitoring tools (e.g. reviews and on-site inspections on individual firms), or carry out thematic work on a very limited basis (e.g. only when participating in conferences or hearings with firms).</p>
<p><b>B.9</b></p> <p><b>Effective supervision and testing of internal approaches and risk models</b></p>	<p>13 CAs (BG, CY, DK, EE, EL, HU, LI, LT, LV, MT, PL, RO, SI) have not formalised an internal procedure or established clear practices whereby they are able to verify their approaches to supervising MiFID conduct of business provisions, including best execution, and to test, where risk models are used, these appropriately.</p>
<p style="text-align: center;"><b><u>SUPERVISION OF BEST EXECUTION ARRANGEMENTS AND POLICIES</u></b></p> <p><b>Full application:</b> AT, BE, CZ, DE, ES, FI, FR, HU, IE, IT, LU, LV, NL, NO, PT, RO, SI, SK, UK</p>	

<p><b>Partial application:</b> DK, EE, EL, MT, SE</p> <p><b>Insufficient application:</b> BG, CY, LI, LT, PL</p>	
<p><b>C.1</b></p> <p><b>Compliance of execution policies with MiFID</b></p>	<p>Four CAs have not been able to show if or how they carry out the assessment on whether firms put in place arrangements for best execution and a policy which summarises those arrangements:</p> <ul style="list-style-type: none"> <li>• in CY the CA does not seem to perform any independent ongoing supervision in this respect (the assessment is done only at authorisation);</li> <li>• in LI the CA sustains that firms do not need to consider the execution factors because the entity to which orders are routed (the custodian bank specified by the client) is responsible for best execution, while asset management companies perform an entirely passive role in this respect;</li> <li>• in LT the CA says it checks the policy during on-site inspections but does not provide further details;</li> <li>• in PL the CA takes into account that most of the investment firms execute orders on the regulated market of the Polish Stock Exchange GPW. So, according to this CA, the rules of best execution lose <i>de facto</i> their meaning.</li> </ul>
<p><b>C.3</b></p> <p><b>Supervision on the involvement of the firms' compliance function and approval by the board</b></p>	<p>2 CAs have not been able to show how they review that the compliance-function is appropriately involved in the development, application and review of the execution policy and that the execution policy is approved by the board/senior management:</p> <ul style="list-style-type: none"> <li>• the CAs of BG and PL do not show how the approval of the best execution policy by the board/senior management is reviewed.</li> </ul>
<p><b>C.4</b></p> <p><b>Review of further documentation</b></p>	<p>In 1 MT, the CA has not been able to show whether and how it reviews any other relevant documents from firms relating to best execution, including reports by the compliance function on how the execution policy is working in practice.</p> <p>In PL, the CAs does not perform any review of any other relevant documents from firms relating to executing, or transmitting orders or decisions to deal; in addition to the information contained in the policy. Neither does the CA review reports by the compliance function on how the execution policy is working in practice</p>
<p><b>C.5</b></p> <p><b>Assessment of the</b></p>	<p>4 CAs have not been able to show if and how they assess whether the processes used by the firms to select the venues/entities included in the "policy" (for firms transmitting client orders or decisions to deal) or</p>

<p><b>processes</b></p>	<p>execution policy (for firms that execute orders or decisions to deal) are capable of achieving compliance with their best execution obligations:</p> <ul style="list-style-type: none"> <li>• the CA of CY, MT and SE reported that they do not assess this;</li> <li>• the CA of LI stated that firms do not need to consider the execution factors because the custodian bank to which orders are routed is responsible for best execution. As mentioned, this description does not appear to be in line with MiFID.</li> </ul>
<p><b>C.6</b></p> <p><b>Review of the assessment of the execution factors</b></p>	<p>7 CAs have not been able to show if and how they review how the firms assess the relative importance of the best execution factors in order to obtain the best possible result:</p> <ul style="list-style-type: none"> <li>• the CAs of CY, DK, EE, EL, MT reported that they do not conduct this review;</li> <li>• in the case of LI it is not clear how the CA reviews the entire execution chain and ensures application of the best execution provisions;</li> <li>• The CA of SE mainly reviews the relative importance of the best execution factors in the authorisation process. SE considers this to be in line with the risk based approach.</li> </ul>
<p style="text-align: center;"><b><u>REVIEW OF APPROPRIATE INFORMATION PROVIDED TO RETAIL CLIENTS</u></b></p> <p><b>Full application:</b> AT, BE, BG, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LU, LV, NL, NO, PL, PT, RO, SI, SK, UK</p> <p><b>Partial application:</b> CY, MT, RO</p> <p><b>Insufficient application:</b> LI, SE</p>	
<p><b>D.1 and D.2</b></p> <p><b>Review of appropriate information to retail clients</b></p>	<p>The CAs of LI and SE reported that they do not review that firms provide appropriate information to retail clients to enable an adequate understanding about the key aspects of the firms' execution policy (for firms that execute orders or decisions to deal on behalf of client portfolios) or policy (for firms that transmit orders or decision to deal) and that this information is in fact disclosed.</p>
<p><b>D.3</b></p> <p><b>Review of provision of additional information to</b></p>	<p>The CAs of CY, LI, MT, RO and SE reported that they do not review that any additional information about the execution policy of firms which</p>

<b>clients</b>	execute orders or decisions to deal is disclosed to the firms' retail clients as a matter of course or upon request.
<b>D.4</b>  <b>Review of appropriate arrangements and procedures to collect clients' consent</b>	The CA of SE reported that they do not consider whether firms have set up appropriate arrangements and procedures (or other measures) to collect clients' consent.
<p><b><u>SUPERVISION OF ABILITY TO DEMONSTRATE ADHERENCE TO POLICY</u></b></p> <p><b>Full application:</b> AT, BE, BG, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, NL, NO,PT, RO, SI, SK and UK</p> <p><b>Partial application:</b> MT, PL</p> <p><b>Insufficient application:</b> LI, SE</p>	
<b>E.1</b>  <b>Supervision of firms' ability to demonstrate adherence to policy</b>	2 CAs (LI, SE) reported that they do not review firms' procedures and arrangements for demonstrating, at a client's request, that they have executed any individual order or decision to deal in compliance with their execution policy. In the case of LI, the CA sustains that their approach is justified since in their market firms merely pass orders to one trading entity (the "custodian bank"); in SE the CA considers that the lack of supervision on this topic is consistent with their risk-based approach.
<b>E.2</b>  <b>Supervision of firms' ability to obtain the best possible result on a consistent basis</b>	3 CAs (LI, MT, PL, SE) do not review that the firm is able to demonstrate that it can obtain the best possible result on a consistent basis, as long as the firm has only one execution venue listed in its execution policy for a particular type of financial instrument.
<p><b><u>SUPERVISION OF ABILITY TO MONITOR AND REVIEW</u></b></p> <p><b>Full application:</b> AT, BE, BG, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, NL, NO, PL, PT, RO, SI, SK and UK</p>	

<p><b>Partial application:</b> MT</p> <p><b>Insufficient application:</b> LI, SE</p>	
<p><b>F.1, F.2 and F3</b></p> <p><b>Supervision of firms' regular monitoring and reviews of their policy and arrangements</b></p>	<p>Two CAs (LI, SE) indicate that they do not assess whether firms have put in place appropriate processes: (i) for monitoring, on a regular basis, the effectiveness of their best execution arrangements and policies; (ii) for reviewing their policies and arrangements on a regular basis; (iii) for reviewing their policies and arrangements in light of a material change that affects the firms' ability to achieve the best possible result on a consistent basis.</p>
<p><b>F.4</b></p> <p><b>Monitoring techniques in relation to different instruments and orders type</b></p>	<p>Three CAs (LI, MT, SE) indicate that they do not check whether firms' monitoring techniques vary according to instrument type or order type.</p>

## A. Background information

52. In order to provide some background on the market size and general regulatory and supervisory framework, the competent authorities have been requested to respond to some preliminary questions.

### A.1 - Number of Investment Firms and Credit Institutions

53. The CAs have made available figures in relation to the number of investment firms and credit institutions subject to the best execution rule authorised in each of their jurisdiction.

**Table 4. Number of investment firms and credit institutions subject to the best execution rule authorised in each jurisdiction**

	Number of Investment Firms and Credit Institutions <sup>20</sup>
AT	802
BE	132
BG	78
CY	191
CZ	64
DE	2485
DK	187
EE	27
EL	103
ES	516
FI	323
FR	956
HU	48
IE	172
IS	not participating in survey
IT	786
LI	119
LT	36
LU	285
LV	41
MT	53
NL	274
NO	150
PL	71
PT	58
RO	58
SE	99
SI	19
SK	29

<sup>20</sup> Cut off date is 31 December 2013

54. On the basis of the above, it appears that most of investment firms and credit institutions subject to the best execution rule are located in UK (4,143), followed by DE (2,485), FR (956), AT (802), IT (786), ES (516), and FI (323).

## A.2 - Shared competences

55. The Peer Review shows that, notwithstanding any shared competences in the licensing process with other national authorities, e.g. prudential regulators, in 2 cases (CY, SI), the CAs share the competences on the supervision and enforcement of the best execution rule with other national authorities, whilst in the remaining 27 (AT, BE, BG, CZ, DE<sup>21</sup>, DK, EE, EL, ES, FI, FR, HU, IE, IT, LI, LT, LU, LV, MT, NL, NO, PL, PT, RO, SE, SK, UK) the CAs do not.
56. In CY, there are two supervisory authorities: the CySEC in relation to investment firms and the Central Bank of Cyprus (CBC) in relation to credit institutions, which work in close cooperation.
57. In SI, the CA shares competences with the national central bank, in relation to the supervision over the operations of a bank, whether a Member State bank, a special financial institution or a third country bank, regarding its investment services and activities (including best execution).
58. In the above-mentioned cases where competences on the supervision and enforcement of the best execution rule are shared with other national authorities (CY, SI), the cooperation between such authorities is regulated by a bilateral agreement (SI), or a multilateral memorandum of understanding signed by all the supervisory authorities of the financial sector (CY).

## A.3 - Internal organisation

### A.3.a - General description of the units involved and resources applied

59. In all CAs, the supervision of the best execution rule is included in the general supervision of MiFID provisions. Therefore there are no dedicated resources, but the staff conducting the supervision of MiFID provisions in general is also responsible for the supervision of best execution.
60. In 21 CAs (AT, BE, CY, CZ, DE, DK, ES, FI, FR, HU, IE, IT, LI, LT, LU, LV, NL, NO, RO, SE, UK) more than one unit is involved in the supervision of MiFID conduct of business provisions, including best execution. For instance in AT, DE, IT, LI, LU, SK there are separate departments, or separate units within the same department dealing with investment firms and credit institutions; while in CY, CZ, EL, HU, NO, RO, UK the authorisation unit/department is distinct from the on-going supervisory unit/department.

<sup>21</sup> In DE, the CA reported that the central bank (Deutsche Bundesbank) has got a supporting role as regards credit institutions. On behalf of BaFin, the Deutsche Bundesbank evaluates a minor amount of reports of the annual examination of credit institutions. However, BaFin then decides whether to follow the evaluation and the further procedure towards the investment firms. The Deutsche Bundesbank itself has got no power in this matter. An agreement with the Deutsche Bundesbank or a hearing of the Deutsche Bundesbank is not necessary.

61. In some CAs (BG, EL, MT, NO, PL, PT, SI, SK) the supervisory function is carried out by one unit. In some of these cases the units are split into several sub-units or teams (BG, NO, SI, SK). In LV, the CA mentioned that there are no more than 3 supervisory experts involved in the supervision of best execution. In DK the supervision of best execution is mostly handled by a small unit with direct access to senior management.
62. In some CAs (EE, EL, LI, NO, PL) inspection and enforcement are under the responsibility of the same units carrying out supervision. Other CAs (BG, CY, ES, FR, IT, LU, PT, RO) mentioned that they have a unit or an ad hoc team dedicated to inspections and some CAs have a separated enforcement unit which may be entirely or partly responsible for, or involved in, the application of sanctions (AT, BE, BG, CY, CZ, DE, ES, FI, FR, HU, IE, IT, LT, LU, LV, MT, PT, SE, SI, SK, UK). In EE Market Supervision and Enforcement Division is responsible for best execution rule supervision.

### **A.3.b - Operation of internal governance and oversight**

63. In all CAs the operation of internal governance and oversight is ensured through a number of different means, which include a clear and documented decision making process, the periodic identification of internal strategies and priorities, the role of an internal audit function, and the accountability of the CA toward the national Parliament. The means used very much vary across CAs. The paragraphs below show an indication of major trends.
64. In most of the cases (BE, CY, CZ, DE, DK<sup>22</sup>, EL, EE, ES, FI, FR, HU, IE, IT, LI, LU, LV, MT, NO, SE, SI, SK, UK), CAs mentioned that the staff entrusted with the supervision of MiFID provisions, including best execution, are accountable to the head of the unit, and regular reporting is made to the decision-making body of the CA according to formalised internal procedures.
65. In 19 CAs (AT, BE, CZ, DE, ES, FI, FR, HU, IE, IT, LI, LU, NO, PL, PT, SE, SI, SK, UK), there are one or more internal instructions or handbooks which describe the supervisory, inspection and enforcement processes, including the review of investment firms' compliance with best execution.
66. In 12 CAs (AT, BE, EE, ES, FI, FR, HU, IE, IT, NO, SE, UK) the strategies, objectives and priorities in relation to the supervision of best execution are established, according to formalised governance procedures, by the decision-making body of the CA. In one CA, they are established only by law (PT).
67. In 22 CAs (BE, BG, CY, DK, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, NL, NO, PT, RO, SE, SI, SK, UK), the final decision concerning enforcement actions is made by the Board of the CA, by the Chairman or vice-Chairman of the CA, by another delegated management body or the Enforcement Committee of the CA. Among these CAs, in 10 cases (AT, BE, CY, EL, IT, LI, LT, LV, NO, RO), enforcement actions are adopted by the Board or another delegated management body on the basis of a proposal of a dedicated unit entrusted with the supervision of MiFID provisions or the investigations unit (CY). In 10 CAs (AT, BG, CZ, ES, FI, FR, IE, IT, SE, UK), there is an enforcement unit that investigates independently the results of the supervisory and inspection activity carried out by the supervision and inspection units and proposes to the Board /Enforcement Committee whether to adopt sanctions. In 3 CAs, the dedicated enforcement unit handles only more serious breaches

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<sup>22</sup> Not on a regular basis



(BE, CZ, LT). In DE the final decisions concerning enforcement actions are regularly made by the heads of the competent units and are based on the proposals of the policy or senior policy officers and only in case of fundamental questions the head of the department or the Chief Executive Director needs to be involved.

68. In SK, the CA's answer focused only on the internal decision making process relating to on-site inspections.

#### **A.4 - General supervisory approach**

69. In most CAs (AT, BE, BG, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LI, LT, LU, LV, MT, NL, NO, PT, RO, SE, SI, SK, UK), the approach to supervise compliance with best execution does not differ from the regular approach used by the competent authorities to supervise the application of MiFID conduct of business rules. In PL, it is pointed out that, although best execution is part of the conduct of business requirements, the CA may well treat best execution as a separate subject of supervision, since it is subject to a separate catalogue of investment firms' commitments.
70. In most of the cases, CAs employ mainly or partly risk-based supervision, although a variety of different approaches apply in practice. In particular, the type and frequency of periodic reporting by supervised entities, the parameters triggering alerts to identify the risks and prioritize actions, the level of reliance on external auditors in carrying out the monitoring, the frequency and scope of on-site inspections and thematic reviews are areas where significant differences are detected. In addition, in most of the CAs, the approach employed for the supervision of best execution equally includes both desk-based and on-site reviews, whilst in others the main tool is on-site inspection. For more detailed analysis, please refer to Section B (in particular Sections B-3 to B-6) below.
71. In 6 CAs (AT, BE, DE, LI, LU, MT), the supervision of best execution is conducted with the support of external audit firms.
72. Some CAs (CZ, DE, FR, LI, LU, PL, PT, SE, UK) expressly mentioned that supervision of best execution is influenced by market specificities. For instance, in PT the CA mentions that securities are traded mainly on regulated markets and the local market is small and developing. In CZ, the CA makes reference to the low liquidity of the market. In LI, only banks and larger investment firms are allowed to perform the entire spectrum of MiFID services. In the UK, one specific feature is the connection between execution quality and inducements resulting from certain UK market microstructures. In FR, the CA mentioned that the end client is rarely in direct contact with the firm executing its order.
73. Some CAs (DK, ES, LI, MT, SI, SE) consider that compliance with best execution is a low risk topic whose supervision does not deserve priority in the country because of market specificities. This is due to the limited number of complaints received in the jurisdictions and clarity of MiFID rules (e.g. in DK, SE, SI), or to the limited number of firms internalising orders (SE), the market concentration for most instruments and low rate of internalization (ES), the increasing use of direct market access services by clients (SE), the limited resources available justifying ad hoc, instead of routine, investigations (DK), the low liquidity of the market (SK), or because no issues were observed in the past on the topic (e.g. SI). Conversely, according to other CAs best execution is a priority sector deserving special focus, due to the lack of clarity of a number of MiFID rules in the area (mainly focused on equity/liquid markets) and the challenges due to the existing market fragmentation (this

is the case, for instance, in BE, IT and UK). On the main challenges observed in this sector please see the analysis under Sections 4 below.

## **B - Organisational and general supervisory approach**

### **B.1 - Clear internal communication of supervisory approaches**

74. As detailed above, in the majority of CAs, supervision of compliance with best execution is part of the overall approach to the supervision of investment firms under MiFID.
75. In 28 cases(AT, BE, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LI, LT, LU, LV, MT, NL, NO, PL, PT, RO, SE, SI, SK, UK), the CA's supervisory approach to best execution is clearly communicated internally. In 1 case (BG) the CA has not been able to show their ability to do so, for the reasons explained below.
76. As regards the ways internal communication is achieved in the above listed 28 CAs, the duties and responsibilities of the units entrusted with the supervision, investigation and enforcement of MiFID obligations, including best execution, have been defined under internal policies and procedures. In smaller CAs the supervision and enforcement of MiFID conduct of business provisions, including best execution, is allocated to one unit only.
77. Some (14) CAs (AT, BE, CZ, DE, ES, FI, HU, IE, IT, LI, NL, NO, PT, SE) mentioned that their plans and procedures are internally published, communicated by e-mail (CZ, DE, SE) or distributed to the staff (LU, SE, SK). In (2) cases (BE, SI), CAs make such policies and procedures publicly available also to interested parties. In particular, in BE, the CA publishes them on its public website.
78. 20 CAs (AT, BE, CY, CZ, DE, DK, ES, FI, FR, HU, IE, IT, LV, NL, NO, PT, SE, SI, SK, UK) reported that their supervisory approach and procedures are also discussed in staff meetings, internal seminars and workshops and informal communications between units, as better described in paragraphs 89 and followings under B-2.
79. In 10 cases (BE, EE, ES, FI, HU, IE, IT, NO, SE, UK) CAs mentioned in their response that they identify priorities and core strategies (including best execution) on a regular basis (which is usually every 2-3 years) and translate these strategies into operational plans. 5 CAs (BE<sup>23</sup>, CY, FI, IT, UK) have identified best execution as a topic gaining or having recently gained priority, whilst in other CAs (ES, FR, LI, LU, MT, PL, PT, SE, SI), this is not the case, mainly due to market specificities (see on this topic par. 92 above).
80. As regards BG, where the supervisory approach does not appear to be clearly communicated internally, the CA asserted to have internal communication, but did not provide details on the means used to communicate their respective supervisory approach on best execution internally.

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<sup>23</sup> It is likely that Best Execution will be a priority in the coming years.

## B.2 - Internal organisation ensuring coherent and consistent supervision

81. All CAs have an internal organisation ensuring that the supervision of best execution as part of supervision of conduct of business activities is conducted in a coherent and consistent way over time and across teams involved.
82. On the means to ensure coherent and consistent supervision, in 27 cases (AT, BE, BG, CY, CZ, DE, DK, EE, ES, FI, FR, HU, IE, IT, LI, LT, LU, LV, NL, NO, PL, PT, RO, SE, SI, SK, UK), the CAs have developed one or more **internal databases** allowing internal sharing and processing of some intelligence or other sources supporting supervision of best execution. In EL the database only keeps information on enforcement decisions taken by the CA's Board of Directors.
83. The content, structure and use of the aforementioned databases vary to a great extent across CAs. In particular, the database may include:
- desk-based supervision documentation and information filed by regulated entities (AT, BE, BG, CY, CZ, DK, EE, FI, FR, IE, IT, HU, LI, LT, LU, NL, NO, PT, SI, SK, UK);
  - on-site inspections documentation (AT, BE, CZ, DE, EE, ES, FI, FR, HU, IT, LI, LU, LV, NO, PT, SK);
  - complaints (BG, CY, CZ, DE<sup>24</sup>, EE, ES, FI, FR, HU, IE, IT, LT, LU, LV, NL, NO, PT, SI, UK);
  - enforcement decisions (AT, BG, CZ, DE, EE, EL, FI, FR, HU, IE, IT, LI, LT, LU, NO, RO, SI, SK, UK);
  - the outcome of risk assessment analysis (CY, CZ, DE, DK, EE, ES, FI, IE, IT, LI, LU, NL, NO, PT, UK)
  - supervisory procedures and handbooks (CZ, DE, EE, ES, FI, HU, IT, NO, PT, SK)
  - access to the CA's archives and registers (CZ, DE, EE, ES, FI, HU, IT, NO, UK);
  - audit reports (HU, IT, LI, LU, NO, SI, SK) or the key results or the evaluation of the audit reports (DE);
  - internal and external correspondence (CZ, DE, EE, ES, FI, HU, IE, IT, LT, LV, NO);
  - documentation relating to investigation (AT, CZ, DE, EE, ES, FI, HU, IE, IT, NO, SI);
  - interpretative communications (CZ, DE, EE, ES, FI, HU, IE, IT, NO, UK).
84. In 14 CAs (AT, BG, CY, DE, ES, FI, FR, IE, IT, LU, NL, NO, SE, UK), the database facilities and the information stored allow to compare firms and define priorities on the basis of the applicable risk-based approach.
85. In 15 cases (AT, CZ, DE, DK, EE, ES, FR, HU, IE, IT, LU, LV, NL, NO, UK), the CAs have developed more than one internal database.
86. In 15 cases (BE, BG, DE, FI, FR, HU, IE, IT, LI, NO, PT, SE, SI, SK, UK), the CAs developed at least one integrated database including information and intelligence on best execution, which combines data received by various sources. Other CAs hold a number of separate databases (AT, CZ, LU, LV, NL) or only one database with information limited to one main source (CY, EL, RO) - on

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<sup>24</sup> CA maintains an internal database of complaints which are reported from the investment firms. The investment firms are only obliged to report complaints which have a relationship to an investment advice. Furthermore complaints filed with the CA by a client are registered in a database. .

the content see paragraph 82. In MT, the CA has not established any database. In PL, the CA saves documents and information in a “cloud system”.

87. Among those CAs holding at least one integrated database, 5 CAs (BG, FI, SI, SK, UK) specified that their database gives access to the transaction reporting data, which provides for trading information relevant for the supervision of compliance to the best execution rules (i.e. information by intermediaries, financial instruments, venues, execution times and customers). In other CAs transaction reporting data is held separately.
88. The level of sophistication of the databases also varies to a great extent, ranging from those (23) storing documents and information electronically (AT, BE, BG, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, LI, LU, LV, NL, NO, PT, RO, SE, SI, SK), to those (5) generating a number of reports to support supervisory, investigatory and enforcement actions (DE, IE, IT, NL, UK).
89. It also emerges that in 13 CAs (AT, CZ, ES, HU, IE, IT, LI, LU, PL, RO, SI, SK, UK), the staff have access only to information pertaining to their competences and responsibilities, whilst in 3 cases (BG, EE, NL), all staff of the CA have access to all information contained in the database.
90. Other means to ensure coherent and consistent supervision are the **organisation of regular internal meetings**. In particular, in 19 cases (AT, BE, CZ, DE, EE, ES, FR, IE, IT, LI, LT, LU, LV, NL, NO, RO, SE, SK, UK), the CAs organise regular meetings across different sections / teams involved in the application of MiFID rules, including on best execution. In 7 CAs (BG, CY, EL, FI, HU, PT, SI) such meetings only take place on an *ad hoc*, rather than on a regular basis, and mainly for limited purposes (e.g.: prior to commencing an investigation or an on-site inspection, or where particular issues are identified in the course of the supervision activities). In DK and SI, such meetings do not take place since only one supervisory division is involved on best execution issues; *ad hoc* meetings are nonetheless organised between inspectors and the supervisory division director. In NL, the CA has established internal dedicated expert groups from several divisions, one of which is on the supervision of investment firms. In MT, the CA does not organise such meetings given that supervisory work on best execution is conducted by one team situated in the same office and therefore the CA does not consider their organisation as necessary.
91. In those CAs where regular meetings on MiFID supervision, including best execution, take place, the frequency of such meetings vary to a great extent, for instance they may be at least weekly (BE, DE, EE, ES, SE), half-monthly (AT, FR, IT, LV), monthly (CZ, LI, LV, SK), or quarterly (IE, LT, LU).
92. During the above-mentioned meetings the following issues are usually discussed, depending on the CAs: on-site inspections issues and results (AT, BE, CZ, EL, ES, FR, HU, IE, IT, FI, LT, NO, RO, SK), annual supervisory reviews (ES, FI, FR, LT, NO), investigation procedures (EE, ES, FR, HU, IT, LI, NO, RO, SI), progress of particular investigation or enforcement proceedings (CZ, HU, LI, SK) , ongoing supervision (BE, BG, DE, EE, EL, FR, HU, IE, IT, LI, LT, LU, NO, SI, UK), work-plans (BE, FR, HU, IE, IT, NO, UK), drafts of interpretative decisions (BE, DE, LT, NO), measures to be taken following the detection of breaches of the relevant laws and regulations (BG, HU, IT, LT, LU, NO, SK), legislative and regulatory proposals (BE, FR, IT, LI, LT, LU, NO, SI, SK, UK), thematic works (FR, HU, LT, NO, UK), international activities (IT, NO).
93. In 23 cases (AT, BE, CZ, DE, DK, EE, ES, IE, FI, FR, HU, IT, LI, LU, LV, NL, NO, PL, PT, SE, SI,

SK, UK), the CAs have in place **other mechanisms** to achieve effective communication across different staff members involved, while 6 CAs (BG, CY, EL, MT, LT, RO) do not.

94. In particular, in AT, CZ, DE, ES, FI, IE, IT, LI, NL, RO, SE, UK, additional means of communication are mailing lists, newsletters or intranet facilities involving different departments, divisions, teams and staff with different responsibilities. In BE, CZ, EE, EL, FI, FR, HU, IE, IT, LI, LV, NO, PL, PT, SE, SI, informal communications and other internal information flows are deemed another useful tool to exchange information between units and staff members. In AT, CZ, DE, IT, LI, NL, SE, UK, the CAs organise *ad hoc* lectures and seminars on particular issues (such as new legislation to be adopted, supervisory topics, exchange of knowledge, training). In DK, HU and SE, however, every year a plan for the supervisory and investigatory activities is made by the supervisory division to specify the type of activities for the coming year (the plan can be adjusted for example in case of urgent or unexpected needs).

### **B.3 - Organisational structure, procedures and resources allowing appropriate supervision and enforcement of best execution**

95. In 25 CAs (AT, BE, CY, CZ, DE, EE, EL, ES, FI, FR, HU, IE, IT, LI, LT, LU, LV, NL, NO, PT, RO, SE, SI, SK, UK), the supervision of best execution practices is part of the CAs' established organisational structure, procedures and resources, while in 4 cases (BG, DK, MT, PL), CAs did not provide sufficient evidence or information supporting this conclusion for the reasons explained below.
96. The above CAs have established an internal organisational structure for the supervision of MiFID rules of conduct, including best execution, through organisational plans or similar means. As reported above (see particularly Section A), in most CAs the supervision is carried out by several competent units within the CA, while in others (BE, DK, IE) the CAs have established a unit, a team or a working group for the supervision of rules of conduct including best execution.
97. In terms of procedures, most of the CAs have developed internal supervisory practices and work programmes including on best execution and, in many instances, have also established means to ensure their consistent application. However, the level of formalisation of such procedures varies to a great extent. Some CAs (AT, BE, CZ, DE, EE, ES, FI, FR, HU, IE, IT, LI, LU, NL, PT, SE, SI, SK, UK) have established handbooks, manuals or circulars in areas ranging from the supervision, to the detection, investigation and enforcement of best execution (although not necessarily focused on this topic only), whilst others have formalised procedures only on limited aspects, mainly in relation to enforcement. Finally, a few CAs (BG, LT) have no formalised procedures, due to the limited size of the market.
98. A number of CAs (BE, DE, IE, IT, NL, SE, UK), mentioned, among other things, the importance of hiring and training with a view to ensuring proper knowledge and supervision of MiFID rules of conduct, including best execution.
99. 22 CAs (AT, BE, CY, CZ, DE, EE, EL, ES, IE, FI, FR, IT, LI, LU, MT, LV, NL, NO, PT, SE, SI, UK) make use of some risk-based analysis to prioritise their actions in connection with best execution, although a variety of approaches are endorsed in practice, as better specified also in the following paragraphs dedicated to the various supervisory tools.

100. The peer review shows that while in 18 CAs (AT, BE, CZ, DE, EE, EL, ES, IE, FI, FR, IT, LU, LV, NL, NO, PT, SE, UK) the supervisory approach is mainly risk based and the risk analysis is applied when making use of any tools employed for the supervision of best execution (e.g.: desk-based reviews and on-site/thematic visits), in others the risk analysis is used for more limited purposes, such as in connection with one or the other tool (detailed in the paragraphs B4 and following).
101. 5 CAs(AT, DE, LI, LU, MT) endorse a two pillar approach<sup>25</sup> in the supervision of best execution whereby reliance is placed on the supervisory findings of external audit firms.
102. As regards the 4 CAs (BG, DK, MT, PL) which were not able to show that the supervision of best execution is part of the CAs established organisational structure, procedures and resources:
- in DK the CA pointed out that so far it has not systematically and routinely conducted supervisory activities focused on best execution; investigation on this topic have been merely *ad hoc*. The resources dedicated to it appear to be limited.
  - in BG, the CA mentioned that the staff has to follow a handbook for inspections, but has not explained how staff is instructed to ensure appropriate supervision and enforcement where tools other than on-site visits are employed;
  - in MT, other than possible review through on-site visits there are no clear predefined procedures for the supervision of best execution and no database has been established by the CA to support its activity in this regard. Moreover, it appears that best execution is not considered as a major concern in the Maltese market and therefore it is given low priority in MFSA's supervisory approach;
  - in PL, while overall the CA appears to have organisational arrangements for supervision of conduct of business and there are formal lines of communications between departments, it is not clear from the assessment how frequently this organisational structure is used in relation to best execution.

#### **B.4 - Clear supervisory approach and relevant criteria**

103. The review shows that (22) CAs (AT, BE, CY, CZ, DE, EE, ES, FI, FR, HU, IE, IT, LT, LU, LV, NL, NO, PT, SE, SI, SK, UK) have a clear approach setting out how they supervise compliance with best execution and when and how to take actions. Relevant criteria include:
- (i) scale of activities or volume of investment products covered;
  - (ii) volume of complaints and alerts received;
  - (iii) indicators from the regular review of audit reports or indicators from the review of information and data transmitted by investment firms;

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<sup>25</sup> Certain CAs use in their supervision reports prepared by statutory auditors of the intermediaries. These reports include a judgment on the compliance with MiFID obligations, including best execution. The level of reliance of the CA on these reports and consequently the level of direct supervisory activities seem to vary from one CA to another. The report of the auditors is usually provided on annual basis, together with audited accounts, and then it is subsequently analyzed by the authority.

- (iv) nature of complaints and alerts received;
- (v) type of products.

104. Many of these CAs the aforementioned factors as input data for their risk model (BE, CY, CZ, FI, IE, IT, LT, NL, NO, PT, SE, SI, UK), or they are considered in their risk assessment and prioritisation of actions (AT, DE, EE, LU). Six CAs (AT, BG, FI, HU, LT, LV) employ the factors in the selection of firms for their on-site inspections and in the case of RO and SK also for their desk based reviews. In LU, however, it is not clear how the CA's risk assessment incorporates information relating to best execution.

105. A number (10) of CAs (BG, DK, EL, ES, FR, LI, LU, MT, PL, RO), have not been or have only been able to show partially that they extensively apply the key issues set forth in this peer review as regards the supervisory approach in relation to best execution. In particular:

- two CAs (BG, PL) stated that they employ all the aforementioned factors, but have not provided sufficient evidence or explanations in this respect;
- in EL, the CA seems to rely on factors (ii) and (iv) in the supervision of best execution, while the other factors are employed mainly for prudential supervision;
- in ES, the CA's supervisory approach in relation to best execution mainly relies on onsite inspections, although some desk-based reviews are conducted on the basis of the compliance function's reports submitted on an annual basis to the CA and on the basis of complaints;
- in FR, the CA seems to largely rely on the screening of the best execution policies and procedures performed at the time of authorisation and in case of changes of the firms' business models, while desk-based reviews and on-site inspections are particularly prompted by the compliance function's annual reports submitted on an annual basis to the CA;
- one CA (RO) does not appear to make use of the "type of product" (factor under (v) above);
- two CAs (LI, MT) appear to mostly rely on annual external audit reviews;
- in one CA (LU), it seems that supervision is mostly carried out by the auditors and accounted for in the annual report auditors provide to the CA, although some checks may be performed in the course of broad-scope on-site inspections;
- two CAs (DK, PL) do not appear to make use of indicators from the review of information and data transmitted by investment firms, nor of the regular review of audit reports (factor under (iii) above). The CA of DK also pointed out that the other factors are used indirectly and not in a systematic or formalised way;
- in one CA (LI), there is a lack of clarity on what MiFID business/services asset management firms undertake/perform and this is combined with asset management firms not applying best execution requirements';
- in PL, the supervisory approach of the CA is clearly influenced by the legal regime applicable in

this jurisdiction, which provides for a legal exemption to implement best execution for firms receiving and transmitting orders and directly executing orders in one place of order execution.

## **B.5 - Active monitoring on a desk-based basis**

106. 16 CAs (AT, BE, CZ, DE, ES, FI, FR, IE, IT, LU, LV, NL, NO, PT, SI, UK) perform some active monitoring of compliance with best execution through desk-based reviews, without relying excessively on external resources, while in 13 CAs (BG, CY, DK, EE, EL, HU, LI, LT, MT, PL, RO, SE, SK), this is not the case for the reasons explained below.
107. Nonetheless, even where active monitoring on a desk-based basis is applied, the approach to the reviews, the relevant frequency, intensity and coverage scope vary to a great extent among CAs.
108. As regards the reviews of information from investment firms, in 5 CAs (BE, FI, IE, IT, SK) periodic and/or ongoing firm reporting is one of the main sources of their desk-based reviews on best execution, whilst in 3 cases (EE, EL, NL) the main source is firms' responses to *ad hoc* or periodic self-assessment questionnaires sent by the CAs.
109. In 5 CAs (AT, DE, LI, LU, MT) the external auditors or experts' reports represent the main source used to carry out their desk-based reviews. In these cases, more in-depth analysis is carried out by CAs (AT, DE, LI, LU, MT) mainly where particular deficiencies or weaknesses emerge from those reports.
110. In AT, the CA mentioned that an additional source of information is a detailed questionnaire with 50 questions which is annually sent to investment firms, in addition to investor's complaints. In UK external audit reports are used on an *ad hoc* basis, when deemed appropriate, while in IE, as mentioned, they are used only in connection with selected firms.
111. 8 CAs (DK, EL, ES, FI, HU, NO, PT, SE) rely more on on-site inspections than on desk based reviews when supervising best execution. Among these CAs, in some (BG, HU, LI, PL, SE) no regular desk based reviews are carried out as regards the supervision of best execution; these CAs conduct some desk based reviews on an *ad hoc* basis, and/or in connection with other supervisory tools (e.g. in terms of reviews of firms' information before or in connection with an on-site inspection). In NO desk based reviews are focused on the collection of information for compiling the firms' risk models, which are then used to select firms for on-site visits.
112. According to the information available, 6 CAs (AT, DE, ES, FR, LU, LV, NL) carry out desk based reviews including in relation to best execution at least on a yearly basis. In EE self-assessment questionnaires are sent to firms once every 3 years. In 3 CAs (BE, CZ, IT) desk-based reviews are carried out on an ongoing basis, e.g.: following the receipt of information in accordance with periodic and "timely" reporting obligations on all firms (i.e.: the reporting shall take place every time a material change occurs).
113. In 7 CAs (BE, DE, ES, FR, IT, LI, LU), the intensity of the review of information varies depending on the risk ranking given to the firm.



114. In 4 CAs (IE, LV, NL, UK), not only the intensity, but also the coverage and frequency of the reviews vary depending on the risk assessment of the firm. It should be noted that in the UK there is a periodic cycle of reporting applying also to smaller firms.
115. In 15 CAs (BG, CY, DK, EE, EL, HU, LI, LT, MT, PL, RO, SE, SK), active desk based monitoring of best execution does not take place extensively because:
- the CAs desk based reviews do not include periodic reporting by firms or independent auditors (DK, EL<sup>26</sup>, RO);
  - the CAs desk based reviews do not include information from other competent authorities, where available (DK, RO);
  - the CAs do not include any of the sources of information listed in the key issue relating to active desk based monitoring (DK, PL);
  - the CAs perform active desk based reviews only on a very limited basis and mostly in connection with on-site inspections or limited information has been provided on the various desk-based information sources (BG, CY, EE, HU, LT, RO, SE, SK);
  - weaknesses are desk-based monitored mostly on the basis of external audit reports and, where available, customers complaints; the CA appears to place excessive reliance on external sources, without carrying out sufficient own desk-based analysis (LI, MT).

## **B.6 -Periodic and non-routine on-site inspections**

116. Almost all CAs plan and carry out periodic on-site inspections on MiFID provisions, including best execution, where appropriate, while in one CA (PL) this is not the case since it seems that the CA has not developed any criteria for prioritising onsite inspections. However, the approach to on-site inspections, the relevant coverage, frequency and scope vary to a great extent among CAs.
117. In particular, 4 CAs (HU, RO, SI, SK) review every investment firms according to an inspection cycle lasting from two to five years.
118. Other (21) CAs (BG, BE, CY, CZ, DE, EE, EL, ES, FI, FR, IE, IT, LT<sup>27</sup>, LU, LV, MT, NL, NO, PT, SE, UK) select the investment firms subject to on-site visits according to pre-defined (usually risk based) criteria. In BG, BE, CY, CZ, DE, EE, ES, FI, FR, IE, IT, LI, LU, LV, MT, NL, NO, PT, SE, UK, CAs developed a scoring model based on risk assessments. Such risk assessment are mainly based on information received by the firms (BE, BG, CY, CZ, EE, EL, ES, FI, FR, IT, LU, MT, NL, NO), investor complaints (BE, BG, CY, CZ, DE, EE, ES, FI, FR, IE, IT, LI, LU, LV, MT, NL, PT), information filed by external auditors (CY, CZ, DE, ES, FI, IT, LI, LU, MT), information received by other authorities (BE, CY, CZ, IT, NO), media review (CY). In addition, the risk factors considered in

<sup>26</sup> In the case of EL, according to the evidence provided, it seems that the CA mostly performs reviews on best execution during onsite inspections, which may be also prompted by investor complaints.

<sup>27</sup> In LT scoring model is still under development.

the assessment are the following: scale of activities (BE, BG, CY, CZ, DE, EL, FI, FR, IE, IT, LU, LV, NO, PT, SE, SI), complexity of business or of products offered (BE, CY, CZ, DE, EL, FI, IE, IT, LV, NO, PT, SE, SI), volume and nature of complaints (BG, CY, CZ, DE, EL, FI, IE, IT, LV, NO, PT).

119. Two CAs (DK, PL) have not developed a fixed set of criteria to select firms to be inspected. However, the CA of DK generally tends to take into account the market size, the number and the nature of complaints, business mode and relevant complexity.
120. 11 CAs (BG, FR, HU, IE, IT, LT, NL, NO, RO, SE, UK) carry out thematic onsite inspections.
121. 23 CAs (AT, BE, BG, CY, CZ, DE, EL, ES, FI, FR, HU, IE, IT, LT, LU, MT, NO, PT, RO, SE, SI, SK, UK) have carried out on-site visits during the review period, which included best execution issues. In particular, 5 CAs (CY, IE, LT, PT, SI) stated to have carried out from 1 to 5 inspections, 3 CAs (BE, CZ, FI) from 4 to 10 on-site inspections, 4 CAs (FR, IT, NO, SK) from 11 to 20. In BG, the CA carried out 21 onsite inspections (14 general on-site inspections and 7 thematic on-site inspections). 1 CA (LT) carried out two periodic on-site inspections on compliance with the MiFID requirements, including best execution rules.
122. 3 CAs (EE, LI, PL) have not conducted any onsite inspection relating to best execution rules in the review period, while the remaining CAs failed to provide figures.
123. As regards the scope, 14 CAs (DE, HU, ES, IE, IT, LI, LU, LV, LT, NO, PT, SE, SI, UK) usually perform broad on site visits covering reviews of compliance with all MiFID provisions, whilst other CAs (AT, BE, CY, FI, FR) usually make a selection of the subject matters to be reviewed. In some cases (BG, CZ, EL, MT) both approaches equally apply.
124. All CAs are able to perform both routine (i.e.: planned) and non-routine (i.e.: event-triggered) visits. Only in some cases (BG, CZ, DE, ES, FI, IT, LI, LU, UK), CAs have established a clear process to determine when non-routine inspections should be performed. In DK the CA stated that non-routine inspections are the primary and the most resource-effective supervisory activity in relation to the CA's supervision of best execution, due to the limited supervisory resources and to the fact that best execution is a rather limited area within an overall supervision of conduct of business rules.
125. Non-routine onsite inspections are mainly triggered by investor complaints (BE, CY, CZ, EL, ES, FI, HU, IT, LI, LV, RO, SE), when there is a suspicion of possible irregularities (BE, BG, CZ, ES, HU, FR, IT, LI, MT, NL, SE, RO, SI), where information is received by other authorities (BE, BG, CY, IT, SE), through media review (ES, IT), changes in the management structure or ownership of an investment firm (BG).
126. 4 CAs (FI, NL, SE, SI) reported that onsite inspections are usually ex-ante announced to the firm subject to inspection. In IT, all inspections are performed without such prior notice.
127. In 3 CAs (DE, LI, LU) onsite visits may also be performed by external auditors acting on behalf of the CAs. In DE, with reference to non-routine inspections, it is mentioned that such audits can also be conducted by external auditors who are commissioned by the CA. In LI, the CA may accompany the audit firms on a fixed number of visits to asset management firms.

128. As mentioned in section B-5, in 9 CAs (BG, DK, EL, ES, FI, NO, PT, SE, SI) onsite visits are mentioned as the main supervisory tool they employ in order to verify compliance with best execution.

### **B.7 -Face to face meetings and hearings with senior management**

129. All CAs are able to conduct face-to-face meetings and hearings with senior managers of investment firms to assess compliance with MiFID provisions, including best execution, where appropriate.

130. However, whilst some CAs (AT, CY, DE, DK, EE, FI, FR, IE, IT, LI, LU, LT, LV, NL, NO, PT, RO, UK) employ them on a routine basis as a general and proactive supervisory tool, others (BG, CZ, EL, ES, HU, MT) make use of them only in the course of on-site visits (e.g. to plan the visit, and/or to discuss findings) and/or when undertaking inspections or enforcement actions.

131. In SE, SI and SK, although CAs are able to conduct face-to-face meetings, no such face-to-face meetings covering best execution were conducted during the review period, since best execution is not a priority topic in these jurisdictions, or in the case of SK no issues were detected.

132. 3 CAs (CY, EL, NO) did not provide examples of face-to-face meetings carried out in the review period in relation to best execution issues.

### **B.- Thematic work**

133. 25 CAs (AT, BE, CY, CZ, DE, DK, EL, ES, FI, FR, HU, IE, IT, LI, LU, LT, MT, NL, NO, PT, RO, SE, SI, SK, UK) have established an approach to determine where undertaking thematic work (whether specifically on best execution or with a broader focus). 4 CAs (BG, EE, LV, PL) have not been able to show their ability to do so, since they appear to make use only of other monitoring tools (e.g. reviews and on-site inspections on individual firms), or carry out thematic work on a very limited basis (e.g. only when participating in seminars or hearings with firms).

134. The approach, purpose, frequency and coverage of thematic work concerning, specifically or among others, best execution vary to a great extent among CAs. In particular, in (17) CAs (AT, BE, CY, CZ, DE, DK, FI, FR, HU, IE, IT, LU, NL, NO, SE, SI, UK) thematic work is used broadly to assess common practices and emerging risks as well as the level of compliance of firms with a particular set of provisions or the reaction to new regulatory initiatives or other developments. In 1 CA (EL) thematic work is used for more limited purposes, for instance as a means to request firms to provide information which will be used to select firms for on-site inspections. In 2 CAs (BG, RO), thematic work has only been performed in the form of thematic inspections and/or hearings.

135. During the review period 10 CAs (DK, FI, FR, HU, IE, IT, NL, RO, SE, UK) carried out thematic work covering the topic of best execution, whilst other CAs did not. In SE, thematic investigations concerned complex products. In IT, the CA plans to carry out a thematic review to map how smart order routing systems work in practice, with a view to ensure that firms comply with the best

execution requirement when executing the orders of their clients. In FR, the CA conducted a thematic review that resulted in a guide, published in August 2014, gathering recommendations to supervised entities, which also covers best execution issues in relation to classes of instruments other than equities and to professional clients as well as best selection issues.

136. Among those who have established an approach to conduct thematic work on MiFID provisions including best execution, 11 CAs (BE, CY, CZ, DE, ES, LI, LT, LU, MT, PT, SI) did not carry out thematic work on best execution in the review period. In PT the CA considers that, due to the low number of institutions subject to supervision, so far thematic reviews have not been an appropriate tool for the subject field. However, in CZ and in DE such thematic work has been conducted respectively in 2010 and 2008, in BE, LI and LU, the CAs did not undertake thematic work entirely dedicated to best execution, but undertook a more general thematic work where best execution was also included, whilst, at the time of the information collection for this assessment, in SI it were being carried from July 2013 and in CY it was planned for 2014.

## **B.9 -Effective supervision and testing of internal approaches and risk models**

137. All CAs, except RO, perceive their range of tools, coverage and intensity of actions as effective in ensuring supervision of best execution, but only few of them (BE, CZ, DE, FI, IT, LI, NO, PT, UK) provided a thorough explanation for such a conclusion. In some cases (EE, CZ, EL, LI, PT, SI) it is mentioned that the low number of complaints relating to best execution support this conclusion. In other cases, the above-mentioned perception is based on the specificities of the market (FI, LI, LT, MT, SI) and small number of firms supervised (FI, LT).
138. As anticipated above, however, only some (15) CAs (AT, BE, CZ, DE, ES, FI, FR, IE, IT, NL, NO, PT, SE, SK, UK) have set up a clear process or a practice to review their ability to achieve supervisory goals and, where risk models are used, to test them appropriately. It seems that the other 10 CAs have not formalised an internal procedure or established clear practices whereby they verify their approaches in supervising MiFID conduct of business provisions, including best execution. This may result in a lack a sufficiently dynamic approach aimed at improving the supervisory outcomes and failures in the ability to change internal supervisory practices whenever emerging risks or material market changes occur.
139. As regards the means to carry out such reviews of the supervisory outcomes, in IT, NL, NO, UK, the CAs carry out ongoing testing on the risk models employed. In AT<sup>28</sup>, BE<sup>29</sup>, ES, FI, FR, the CAs have an internal audit service responsible for analysing the effectiveness of the CA's procedures and supervisory tools. In IE there has been a recent independent review of the risk model as to how effective it has been in delivering high quality supervision. In IT, the CA draws up internal reports on an annual basis that are meant to verify the level of achievements compared to the medium and short term objectives identified under the strategic and operational plans, which may lead to frequent revisions and verifications of risk models and risk analysis. In PT and SK, the CA regularly updates

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<sup>28</sup> In AT the CA has an internal audit specialist team which leads to the publication of relevant findings in an annual report setting forth how to eliminate deficiencies in internal procedures and supervisory tools.

<sup>29</sup> The CA of BE also notices that their MiFID Methodology was designed with the support of various audit firms.

the procedures used, in particular, in case of a change in regulation or in internal decisions<sup>30</sup>. In DE the procedures are reviewed at least annually and amended where necessary, and are also updated in the case of changes in the supervisory law, following a quality check by a central staff unit within the CA<sup>31</sup>. In SE regular follow-up assessment are carried out to evaluate the efficiency of methods, timetable, resources, etc. and whether the objectives identified during the planning of supervisory activities have been achieved and react accordingly.

140. 26 CAs (AT, BE, CY, CZ, DE, DK, EE, ES, FI, FR, HU, IE, IT, LI, LT, LU, LV, MT, NL, NO, PT, RO, SE, SI, SK, UK) developed tools to help firms to better implement best execution requirements, whilst in 3 cases (BG, EL, PL) CAs did not develop such tools.

141. In particular, 14 CAs (AT, BE, CZ, DE, FI, FR, HU, IE, IT, LT, MT, NL, PT, UK) have issued specific guidance or Q & A's relating to MiFID provisions, with a specific focus on best execution, or have published research on such areas (PT). 12 CAs (AT, BE, EE, FI, FR, IT, LT, LV, SE, SI, SK, UK) have organised and/or participated in seminars and hearings with the industry. 5 CAs (DE, FR, IE, IT, SE) CAs have established working groups with the industry to deal with relevant issues concerning the securities supervision, including best execution. 6 CAs (FI, FR, IT, NL, NO, UK) referred to the publication of the enforcement measures undertaken and/or on the main findings of their supervisory activity. In 2 cases (BE, PT) CAs publish their work plan in order to make clear to financial institutions what the supervisor expects to be in place in terms of procedures and controls. 3 CAs (CY, CZ, IT) referred to having set up a dialogue with supervised firms which contemplates responding to their queries and requests for clarifications.

142. In 2 cases (LI, LU) CAs rely on the external auditors' professional practices and feedback provided by them to investment firms relating to specific issues arising in the ongoing supervision of the firm.

## **B.10 - Enforcement actions**

143. 18 CAs (AT, BE, DE, EE, EL, ES, FR, IE, HU, IT, FI, LU, LV, NO, PT, RO, SI, UK) undertook enforcement actions during the review period concerning violations of best execution, whilst 10 CAs (BG, CY, DK, LI, LT, MT, NL, PL, SE, SK) did not. In CZ an administrative enforcement procedure has been opened, but it is not yet final.

144. The range of enforcement actions vary to a great extent among CAs.

145. The types of actions undertaken in the review period are deemed by the relevant CAs to be proportionate to the seriousness of the breach and include letters of observations/direction letters to firms (BE, ES, FR, HU, IE, LU) and orders to firms relating to the remedy of the deficiencies identified (BE, DE, FR, HU, IE, IT, PT, SI), which are both subject to follow up. In addition, public

<sup>30</sup> In addition, as mentioned in par. 128, given the size of the market, in SK all firms are reviewed according to a two year cycle.

<sup>31</sup> In addition, in DE, the CA also performs a review of the annual external auditing which may demand the appointment of a different external auditor, or may lead to a notification to the Chamber of Public Accountancy, which has the disciplinary oversight over the external auditors.

warnings (FI), withdrawal of the authorisation of the firm (FI)<sup>32</sup>, publication of onsite inspections' reports (NO), withdrawal of the authorisation of the firm (FI, LI), and imposition of pecuniary fines (AT, EE, EL, FR, IT, LI, LV, RO, SI, UK) were actions taken.

146. It appears that the figures concerning enforcement actions are, in most of the cases, relatively low. In 7 CAs (EE, EL, FI, FR, IE, SI, UK) undertook among 1 to 5 enforcement actions; 1 CA (PT) among 6 to 10; 2 CAs (IT, RO) among 11 to 20. One CA (RO) mentioned that the sanctions were imposed on the employees of the firm responsible for the breaches detected. In IT, the sanctions were imposed on corporate officers and firms.

147. Other CAs have not specified the number enforcement actions undertaken during the review period.

## **C – Supervision of arrangements and policies**

### **C.1 – Execution Policy compliance with MiFID**

148. Most (25) of the CAs (AT, BE, BG, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LU, LV, MT, NL, NO, PT, RO, SE, SI, SK, UK) assess whether firms put in place arrangements for best execution and a policy which summarises those arrangements<sup>33</sup>. The frequency and the approaches of the reviews (e.g. desk based, during on-site inspections, during licensing process, use of a questionnaire, by an external auditor) vary. Four CAs (CY, LI, LT, PL), however, have not been able to show if or how they carry out this check for the reasons explained below.

149. Most (22) of the CAs check the best execution policy during on-site inspections performed by the CA itself or by an external auditor (AT, BE, BG, CZ, DE, DK, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, MT, NL, NO, PT, SE, SI, UK). Some (11) CAs (BE, CY, CZ, DK, FR, HU, IT, LV, NO, SE, SK) examine the best execution policy (also) during the licensing process. Two of these CAs (CY, SE) seem to check compliance with MiFID requirements only during the licensing process. Two CAs (EE, RO) only use a desk-based approach.

150. Some (6) CAs (BE, FR, HU, IT, PT, RO) receive documents relating to best execution from the investment firms. BE receives and analyses the best execution policy from all investment firms. RO receives internal procedures and rules from investment firms. IT periodically receives from all firms a report including, among others, a summary of best execution policies/arrangements, relevant criteria and main outcomes. In PT the CA requests a list, identifying the relevant persons responsible for carrying out the duties of the investment firm.

151. In 2 CAs (DE, LU) the items mentioned in the key issue are subject to the examination of investment firms by an external auditor. The external auditing is generally conducted annually. In DE the external auditor is bound by the interpretations of the CA set forth in its circulars, e.g. in the

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<sup>32</sup> The cases of the FIN-FSA were based not only on deficiencies regarding best execution obligations, but also on other deficiencies, such as lack of internal control and risk management.

<sup>33</sup> Please refer to Q&A on best execution no. 5 as regards the difference between “execution arrangements” and “execution policy”.

circular MaComp<sup>34</sup> which *inter alia* deals with best execution rules.

152. It is not clear how and to what extent the supervision of best execution takes place in LI. In particular, the CA reported that, because of market specificities, firms route orders to a “custodian bank”, and such firms do not need to consider execution factors. This description is hard to reconcile with MiFID rules, which requires application of best execution provisions in all instances, including where orders are transmitted to a single entity. Moreover, the supervision of firms routing orders heavily relies on external audit reports.
153. Few CAs (EE, FR, SI) use a questionnaire that the investment firms have to answer.
154. Some CAs (BE, CZ, DE, DK, ES, FI, FR, HU, IE, IT, LU, LT, MT, NL, PT, UK) have issued specific guidance or informative Q&As on best execution rules.
155. LT says it checks the policy during on-site inspections but does not provide further details. CY states that it performs a high level assessment during the licensing process and on subsequent policy amendments, when these are included in the compliance officers periodic reporting and approved by management. The CA of CY does not seem to perform any independent supervision in this respect.
156. The CA of PL takes into account that most of the investment firms execute orders on the regulated market of the Polish Stock Exchange (GPW). So, according to this CA, the rules of best execution lose *de facto* their meaning

## **C. 2 - Ability to identify the responsible persons regarding the requirements resulting from the best-execution-rules**

157. All CAs are able to identify the persons responsible for developing the arrangements and policy for executing, or transmitting, orders or decisions to deal.
158. Many (16) CAs (CY, DE, DK, EE, ES, HU, IE, IT, LI, LT, LU, NO, PT, RO, SI, UK) review whether firms are able to identify the persons responsible for developing the arrangements and policy for executing, or transmitting, orders or decisions to deal, through the analysis of the organisational plan, a job instruction or a list, questionnaire or other document asked from the investment firms, either on a desk-based basis or during on-site inspections. In DE and LU the review is part of the annual examination by the external auditor. The CA of IT periodically receives a report from all investment firms. The report includes information on the identity of the responsible persons.
159. Some (14) CAs (AT, BG, CY, CZ, EL, ES, FI, HU, IE, IT, LT, LV, NL, SE) review whether firms are able to identify the responsible persons during on-site inspections.
160. Some (3) CAs (CY, LI, NO) review the possibility of identification of the responsible persons (also

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<sup>34</sup> Circular 4/2010 (WA) Minimum Requirement for the Compliance-Function and Additional Requirements Governing Rules of Conduct, Organisation and Transparency pursuant sections 31 seq. of Securities Trading Act (Wertpapierhandelsgesetz – WpHG) for Investment Services Enterprises (hereafter circular „MaComp“).

during the licensing process.

161. Some CAs (FR, MT, PL, UK) points out the role of the compliance-officer. The compliance-officer either is the responsible person itself or they know who is responsible.
162. Four CAs (BE, LI, LU, NO) point out that the responsibility lies within the management. The CA of BE has only contact to the management. In LU investment firms need to report the name of the designated responsible manager on a yearly basis to the CA. In LI the management team is responsible and is authorized by the CA, as well as all changes to its composition need to be authorized. In NO the investment firms need to name the actual manager for each of the investment services. In addition, all changes in the organisation and the management need to be reported.

### **C.3 - Involvement of the compliance function and approval by the board**

163. Almost all CAs (AT, BE, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LI, LT, LU, LV, MT, NL, NO, PT, RO, SE, SI, SK, UK) review that the compliance function is appropriately involved in the development, application and review of the execution policy and that the execution policy is approved by the board/senior management. Two CAs (BG, PL) have not been able to show how they entirely meet the requirements mentioned in the key issue for the reasons explained below.
164. The CAs of CY, DE, DK, EE, EL, ES, IT, LU, NO, RO, SE, SK, UK use a desk-based approach, sometimes in addition to on-site inspections.
165. During on-site inspections or through a desk-based review the CAs of CY, CZ, DE, DK, EE, EL, ES, FI, HU, IT, LT, LU, LV, NO, PT, RO, SE, SI, SK, UK review various documents, such as the compliance report/work plan, audits, job and procedural instructions, minutes, e.g. of board meetings, etc. The CAs of DK, NO and SE periodically review minutes from board meetings. NO uses the minutes as part of the preparation for on-site visits. The administrative procedures are cross-checked with the minutes. The CA of UK asks for minutes of the last occasion on which policies were reviewed, which gives an insight into the relevant control framework. Minutes also give an indication of the degree of business involvement, both in the development and approval of relevant policies and procedures. In RO the investment firms need to notify the CA each time an internal policy/procedure is modified.
166. The CAs of CY, FR and IT review the internal procedures manual (CY, IT<sup>35</sup>) or best execution issues (FR) in the licensing process. The best execution issues are often discussed before the CA authorizes the firm to provide investment services. In SK on-site inspections review reports and plans of the compliance officer and reports that were submitted to the senior management and supervisory board of the investment firm. The CA also reviews minutes from board meetings if the best execution policy and other documents were approved by the management.
167. In DE, LI and LU the review of the involvement of the compliance function and the approval by the board/senior management is part of the annual review performed by the external auditors. In DE this

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<sup>35</sup> (see article 8 of Consob Regulation on Intermediaries no. 16190/2007 at the following link: [http://www.consob.it/mainen/documenti/english/laws/reg16190e.htm#Article\\_8](http://www.consob.it/mainen/documenti/english/laws/reg16190e.htm#Article_8))



includes reviewing the rights and the participation of the compliance-function in establishing or changing the best execution policy. Part of the review in DE is also to verify whether the formation of the best execution policy is in accordance with the job and procedural instructions.

168. As regards the CAs which do not meet the benchmark, the CAs of BG and PL do not show how the approval of the best execution policy by the board/senior management is reviewed.

#### **C. 4 - Review of further documentation**

169. Almost all CAs, with exception of the CAs of MT and PL, review any other relevant documents from firms relating to executing, or transmitting orders or decisions to deal in addition to the information contained in the policy, including reports by the compliance function on how the execution policy is working in practice.

170. In many (19) CAs (AT, BE, CY, DE, DK, EL, ES, FI, FR, HU, IT, LI, LT, LU, LV, NO, RO, SE, SK) reports from the compliance-function are reviewed, either by the CAs themselves and/or by an external auditor (DE, LI). In many (14) CAs (BE, CY, DE, ES, FI, HU, IT, LT, NL, NO, SE, SI, SK, UK) the reports from the internal audits are also reviewed.

171. In 11 CAs (AT, CY, CZ, EL, FI, IT, LV, NO, RO, SI, SK) the report from the compliance-function and/or other internal audit reports are reviewed on on-site inspections.

172. In DE and LI the external auditor reviews the reports from the compliance-function. However, if necessary, the CA of DE may always request for the report from the compliance-function or any other internal audit unit. The CA in DE may even ask the compliance-function or any other internal audit unit to examine a certain matter, process or event, and file that report to the CA.

173. The CA of UK states that due to the risk-based approach to supervision it does not keep investment firms' policies and arrangements under constant review and this includes, inter alia, firms' own transaction cost analysis since this would not be proportionate given the resources required and other risks to which they could be applied. However, where the CA has identified issues with best execution compliance it is free to ask for a range of additional data outside of that which is captured in policies and arrangements, including transaction samples, transaction cost analysis, compliance reporting and client challenge of execution quality.

174. Therefore, documents that might be reviewed by the CAs are especially:

- report of compliance-function or any other internal control/audit unit, incl. annual plans, incl. counterparty monitoring;
- any other internal reporting to the firms' Board or to their Risk or Audit Committees;
- report of all of the board actions, undertaken following any identified drawbacks;
- internal guidelines and procedures;
- terms and conditions, incl. price list;
- transaction cost analysis;
- samples of orders, incl. analysis and calculation of costs.

### **C. 5 - Assessment of the processes**

175. 25 CAs (AT, BE, BG, CZ, DK, DE, EE, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, NL, NO, PL, PT, RO, SI, SK, UK) assess whether the processes used by the firms to select the venues/entities included in the “policy” (for firms transmitting client orders or decisions to deal) or execution policy (for firms that execute orders or decisions to deal) are capable of achieving compliance with their best execution obligations (desk based, during on-site inspections, by an external auditor and/or during licensing process). The CA of CY and LI have not been able to show their assessment for the reasons explained below. The CAs of SE and MT reported that they do not conduct such an assessment. SE considers this to be in line with the risk based approach, since this will be the case when an issue is considered a relative low risk area and that compliance reports, internal audit reports etc. are regularly reviewed and should they indicate problems the issue would be addressed.
176. Some (8) CAs (AT, DK, FI, FR, LV, NL, RO, SI) require from the investment firms a description or an explanation of the selection process and of the criteria and data on which the venues/entities are selected. Some of them mention that these requirements are part of an onsite-inspection (AT, BE, RO).
177. Some (5) CAs (CZ, EL, ES, HU, NO) mention that the assessment is part of the onsite-inspections. The CA of CZ reviews how investment firms analyse accessible venues/entities for identification on which of them the investment firm can execute clients’ orders in compliance with best execution.
178. In DE and LU this review is covered by the work performed by the external auditor.
179. In many (17) CAs (BE, DE, EE, EL, ES, FI, FR, HU, IE, IT, LT, LU, NL, RO, SI, SK, UK) it is reviewed whether investment firms distinguish between different types of financial instruments.
180. Concerning financial instruments that are illiquid or traded OTC, some CAs (DE, IT, UK) review which reference price is used as benchmark and whether the firms put in place appropriate mechanisms to ensure that the price of the financial instrument is not unfair or biased by conflicts of interests.
181. Challenges are seen in the execution of orders concerning financial instruments lacking a liquid secondary market and appropriate price discovery mechanism (IT, LU) and in the execution of orders concerning financial instruments traded on the OTC-market (BE, FI, IT, LU, LV, UK).
182. The CA of CY remarks that it makes the assessment in theory, but not yet in practice. The CA of LI considers that the asset management firms do not need to consider the execution factors because the custodian bank to which orders are routed is responsible for best execution. As mentioned, this description does not appear to be in line with MiFID.

### **C. 6 - Review of the assessment of the execution factors**

183. 22 CAs (AT, BE, BG, CZ, DE, ES, FI, FR, HU, IE, IT, LT, LU, LV, NL, NO, PL, PT, RO, SI, SK, UK) review how the firms assess the relative importance of the best execution factors in order to

obtain the best possible result (desk based, during on-site inspections, by external auditors and/or during licensing process). The CAs of CY, LI and SE have not been able to show their review for the reasons explained below. 4 CAs reported that they do not conduct this review (DK, EE, EL, MT).

184. Some CAs (AT, BE, BG, CZ, FI, HU, IT, NO) carry out onsite-inspections in order to review the firms' assessment. Some CAs (AT, FI) say that they require from the investment firms a description or an explanation of the assessment. The CA of FI asks for the present written strategy of brokerage. In some cases the CA of FI has asked the investment firms to demonstrate calculations and pricelists concerning trading on different venues. The CA of CZ demands from the firms a demonstration on a few chosen orders, and how it actually assesses the relative importance of the best execution factors.
185. In DE and LU, this review is covered by the work performed by the external auditor on an annual basis. In DE the review deals with the question whether the investment firm examines whether the execution of securities orders at another trading venue would have led to better execution using meaningful random samples (back testing).
186. During on-site visits, High Level Audits, or during the licensing procedure, the CA of BE makes sure that where different execution venues exist, any additional costs are taken into account when evaluating the obtainment of the best possible result.
187. Some CA review whether the execution factors are assessed in respect of different instruments and markets (SI, UK).
188. The CA of CY remarks that it makes the assessment in theory, but not yet in practice.
189. As mentioned, in the case of LI it is not clear how the CA reviews the entire execution chain and ensures application of the best execution provisions.
190. Three CAs (DK, EL, MT) did not give any further explanation for their answers. The CA of EE explains in its answer that the CA makes the assessment on an ad hoc basis if there is reason. It is the national law that a retail client has to get the best price. The CA of EE believes that if professional clients need to stress some other factor they can do it by giving exact instructions in their orders. The CA of SE mainly reviews the relative importance of the best execution factors in the authorisation process. SE considers this to be in line with the risk based approach.

## **D - Supervision of disclosure and consent**

### **D.1 - Review of appropriate information provided to retail clients**

191. According to the peer review, the majority (27) of CAs (AT, BE, BG, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, MT, NL, NO, PL, PT, RO, SI, SK, UK) review that firms provide appropriate information to retail clients to enable an adequate understanding about the key aspects of the firm's execution policy (for firms that execute orders or decisions to deal) or "policy" for firms that transmit orders or decisions to deal.

192. Almost all CAs (AT, BE, BG, CY, CZ, DE, DK, ES, FI, FR, EE, EL, HU, IE, IT, LT, LU, LV, MT, NL, NO, PL, PT, RO, SI, SK, UK), supervise whether firms issue a specific warning to the client regarding the use of specific instructions. Two CAs (LI, SE) have answered that they do not do so.
193. Some CAs (AT, CZ, EL, FI, HU, LU, PL, SI, NO), reported that they undertake the supervision of information materials through onsite inspections whilst others (EE, FI, FR, NL, SI, SK, UK) mention that they supervise how information is provided to clients by monitoring websites and other disclosure material. 4 CAs (CY, ES, IT, LV) say they do both.
194. 2 CA (DE, LU) use annual external audits for the supervision of the best execution policy. These external audits cover regulatory correspondence, clients' complaints, board minutes and make use of interviewing staff members.
195. 3 CAs (EE, FR, IE) explained that they use thematic reviews as a supervisory tool in this area. 2 CAs (CZ, IT) mentioned explicitly that they use complaints from the public as a supervisory tool; the CA of LT says that they undertake the supervision through "Mystery Shopping".
196. In one CA (UK), supervisory guides and tool kits, e.g. data requests, were used by the supervision team.
197. For the majority of CAs (AT, BE, BG, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, MT, NL, NO, PL, PT, RO, SI, SK, UK), this review includes the relative importance firms assign either to best execution factors or the process by which the firms determine their relative importance. The same CAs also review a list of the execution venues/entities used on which the firms place significant reliance in meeting the overarching execution requirement. Two CAs (LI, SE) answered in the questionnaire that they do not do so, since this is considered to be the outcome of their risk-based approach.

## **D.2 - Review of actual disclosure of information to clients**

198. According to the peer review, the majority of CAs review that the information is in fact disclosed to clients (AT, BE, BG, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LT, LU, LV, MT, NL, NO, PL, PT, RO, SI, SK, UK). Two CAs (LI, SE) reported that they do not.
199. Some CAs (BG, CY, CZ, EL, ES, FI, HU, IT, NO, PL, RO, SI) stated that they review the disclosure procedures through onsite inspections, others say that they undertake a review of the documents provided (AT, BE, ES, IE, HU, NL, SI) and/or of the firms' websites (EE, ES, FI, IE, HU, LT, SI). 2 CAs (DE, LU) undertake the supervision through the use of annual external audits.
200. With regards to different classes of instruments, 3 CAs said they had observed a difference in disclosure (FR, IT, LV), whereas 4 CAs said that they had observed no difference (DE, IE, PT, RO). Unfortunately, the vast majority of CAs did not provide an answer to this question.
201. As the peer review indicates, there are a range of different supervisory approaches to disclosure and the majority of CAs fulfil the best execution requirements reviewing that the content of information provided is appropriate for retail clients. Only 2 CAs, (LI, SE) are assessed as non-

compliant with the key issue.

### **D.3 - Review of provision of additional information to clients**

202. The majority of CAs (AT, BE, BG, CZ, DE, DK, EE, ES, EL, FI, FR, HU, IE, IT, LT, LU, LV, NL, NO, PL, PT, SI, SK, UK) review that any additional information about the execution policy of firms which execute orders or decisions to deal is disclosed to the firms' retail clients as a matter of course or upon request. A minority of CAs (CY, LI, MT, RO, SE) do not do so.

203. However, some CAs (FI, FR, IE, HU, UK) observed that few clients made requests for further information.

204. In BE and EL the CAs' reviews of the provision of information to clients are also triggered by consumer complaints.

### **D.4 - Review of appropriate arrangements and procedures to collect clients' consent**

205. Almost all CAs (AT, BE, BG, CY, CZ, DE, DK, EE, EL, ES, FI, FR, HU, IE, IT, LI, LT, LU, LV, MT, NL, NO, PL, PT, RO, SI, SK, UK) review that firms set up appropriate arrangements and procedures to collect clients' consent. Only the CA of SE responded that it does not do so, since this is considered to be the outcome of their risk-based approach.

206. In some cases (AT, CY, CZ, EL, FI, FR, HU, IT, LT, PL, RO, SI), CAs review these arrangements through onsite inspections, whilst others (DK, MT, SK, IT) review firms' internal procedures. LV reviews these arrangements both through onsite inspections and also through revision of procedures. In 3 CAs (HU, NO, UK), client agreements are reviewed during a firm's application process.

207. Two CAs (DE, LU) review the collection of clients' consent through the use of annual external audits.

## **E - Supervision of ability to demonstrate adherence to policy**

### **E. 1 - Review of firms' procedures and arrangements for demonstrating, at a client's request, that they have executed any individual order or decision to deal in compliance with their execution policy**

208. This review is carried out by almost all CAs. Indeed, only two CAs (LI, SE) do not review the firms' procedures and arrangements for demonstrating, at a client's request, that they have executed any individual order or decision to deal in compliance with their execution policy. The reason they reported for this absence of review is that:

- the CA of LI sustains that there is only one possible trading entity (i.e. the "custodian bank" of the client) and that the "asset management companies" have no choice in terms of trading entities to deal with;

- the CA (SE) considers that the absence of supervision on this topic is consistent with its risk-based approach.
209. Among the CAs which are performing the review referred to in the question, almost all of them (AT, BE, BG, CY, CZ, DK, EE, EL, ES, FI, FR, HU, IE, IT, LT, LV, MT, NL, NO, PT, RO, SK, UK) perform on-site inspections.
210. 2 CAs (DE, LU) perform the review through external audit firms. Only these authorities mentioned a fixed periodicity for their review, which are on an annual basis. The other authorities do not specify any regular frequency for their review; the frequency of the review can therefore be based on a risk-based approach, or depend on the complaints received.
211. In their answers to the questionnaire, a number of CAs have exposed various different methods of conducting on-site reviews specifically on this topic. On occasions CAs, such as BE, CY, DK, NL, may use more than one method at a time.
212. These methods can include:
- a control of a sample of orders, to check whether the firm is able to demonstrate that its best execution policy has been applied to this sample of orders (BE, DE, EL, FI, IE, LV, NL, PT);
  - a review of complaints received from clients (BG, CY, DE, DK, EE, ES, FR, HU, RO);
  - a review of procedures and discussions with the management (AT, CY, DE, DK, ES, FR, IT, LT, LV, NL, NO, UK). The CA of NO notes that quite frequently firms are not able to provide the details required on their controls or procedure, which leads to criticism in the reports.
213. Some authorities (BE, ES, HU, PT) mention that they use an established work programme to check this point. In LU the external auditors also use a questionnaire which includes questions on best execution policy. NL indicates that they may on occasion use the controls performed by the compliance or the audit department.
214. Furthermore, some authorities have conducted thematic reviews including or dedicated to the best execution topic (CZ, DK, FR, IE). One authority indicates that it performs both on-site inspections and desk-based reviews (CY), and the CA of IT also declares that they receive periodic reporting in addition to their on-site inspections.
215. One CA only performs desk-based reviews (SI). Based on this inspection, SI indicates that no complaints or requests for additional information have been made by clients during the period under review (the existence of a procedure to respond to such requests has nevertheless been checked); the CA of IE also indicates that such requests are rare, and the CA of HU states that they have never been informed of the existence of such a request during the period under review.
216. One authority however (BE) indicates that several complaints have been received, which led the CA to conduct a number of ad hoc investigations.
217. One authority mentions that best execution can also be discussed during meetings with the management of a company (AT).

**E.2 - Review that the firm is able to demonstrate that it can obtain the best possible result on a consistent basis where the firm has only one execution venue listed in its execution policy for a particular type of financial instrument**

218. Such a review is also very commonly carried out by the CAs. In particular, only 4 CAs do not carry out such reviews (LI, MT, PL, SE), since:

- In LI, the CA provided the same explanation as the one mentioned in the previous paragraph E.1 which generates the same concerns regarding the lack of information for the client when more than one firm is involved in the provision of the reception, transmission and execution services;
- 2 CAs (MT, PL) do not review that the firm is able to demonstrate that it can obtain the best possible result on a consistent basis, where the firm has only one execution venue listed in its execution policy for a particular type of financial instrument;
- In SE, the CA indicates that this choice is consistent with its risk-based approach of supervision.

219. Nevertheless, the approaches of CAs to reviewing this topic are very different from one to another, and may sometimes appear to be completely opposed, as explained below.

220. Four CAs (BE, FI, LT, LV) indicate that they have a specific approach to this situation, and require specific explanation each time they meet this situation.

221. For instance, the CAs of BE mentioned that their work program has a dedicated question for this situation, which requires that “the regulated undertaking regularly verifies how this [single] entity has executed orders in comparison with the best quotes of that day”;

222. The CA of LT stated that they “ask firms to demonstrate how they can obtain the best possible results on a consistent basis”.

223. Other CAs (EL, ES, IE, DE, IT, LU) consider that the reviews relating to this particular topic are part of the implementation of the best execution policy of the firm, and therefore include their review of this situation in the general review of the firms’ best execution policies. This is done in practice through:

- the test of a sample of operations (EL, IE);
- the review of the procedure (ES, IT), that can be complemented by a review of the complaints and desk-based controls (CY) or by the control of other elements to check whether the firm can demonstrate that it obtains the best results (RO);
- a general on-site inspection (BG, CZ, HU, IT), that can be complemented by meetings with the management and written requests for documents (AT);
- a control that the firms themselves review that the best execution policy is correctly performed (HU, NL, UK);

- an external audit review (DE, LU) which is conducted whatever the number of venue(s) is.
224. Lastly, in SK where the firm has only one execution venue listed in its execution policy, in most cases this relates to financial instruments traded on the Bratislava Stock Exchange. This is reviewed by off-site supervision. The CA also checks through the on-site supervision whether the investment firm can demonstrate that it obtains the best results for the client.
225. There are also different views on how often the firm has only one execution venue listed in its execution policy for a particular type of financial instrument: while some authorities estimate that this is exceptional, and the requests from the client on this issue inexistent (SI, NO, DK) or very rare (IE), PT indicates that such a situation is the norm for Portuguese firms (and therefore includes this situation in the manual used to perform their review).
226. One authority indicates that they have detailed recommendations relating to this specific situation. In particular, the CA of IT mentions that as regards illiquid financial products “very detailed guidelines on this topic are provided under industry codes validated by Consob”.

## **F – Supervision of ability to monitor and review**

### **F.1 - Monitoring effectiveness of firms’ best execution policy and arrangements**

227. All CAs except LI and SE supervise whether firms have in place appropriate processes to regularly monitor the effectiveness of their arrangements and policies on best execution and, where appropriate, correct deficiencies. 4 CAs (EL, LT, SI, SK) review firms’ procedures to find out whether they contain adequate provisions on monitoring. In 2 cases (ES, RO), it is not clear whether they verify merely established procedures or also any supporting documentation.
228. The range of tools employed varies to a great extent among CAs. Some CAs analyze additional documents from firms’ internal review, compliance or other functions to find out how monitoring worked in practice (CY, DE – through an external auditor, DK, EE, IT, PT, UK) and some also raise this issue in interviews with senior management (AT, CZ, HU, LV, MT, NL). Analysis of documentation, whether of the execution policy or of additional internal documents, may be conducted by off-site analysts or by on-site inspectors. 7 CAs (BG, EL, ES, FI, HU, LV, NO) assess firms’ arrangements and policies mainly in the course of onsite inspections.
229. Few CAs (AT, EE, FR) use detailed questionnaires sent to the firms to review firms’ procedures. In 3 cases (CY, IE, IT), the CAs, in case of doubts regarding practical application of internal rules or in case of firms with more risky profile, may conduct additional verification actions.
230. 4 CAs (FR, HU, IE, IT) have also issued or are issuing guidance in this respect. In fact, in IE, the CA issued guidance to supervised entities, requiring them to “monitor the effectiveness of their policy through the assessment of particular transactions on a regular basis”. In HU, the CA issued a Recommendation, in which it also highlights the importance of regular and documented self-reviews to be undertaken by investment firms.
231. In DE the CA recommends that the assessment procedure be implemented using current and



meaningful market data and the same applies to the annual review of the enterprise's execution policy.

232. As signaled above, two CAs (AT, LU) leave most tasks within the best execution area to external auditors. In DE the assessment is part of the annual review performed by the external auditor, which is evaluated by the CA. In FI, the CA analyses details of the monitoring process, including internal audit and compliance reports during inspections, but, moreover, it also looks at how the outcomes of this process is filtered into information provided to customers.

233. In LI, the CA indicates that it does not supervise monitoring and reviewing processes on the basis of alleged market specificities, as further detailed above.

234. SE does not supervise monitoring and review arrangements, arguing that this area is considered to be of relatively low risk. The CA claims that, in accordance with its risk-based approach, if supervisory documentation signals potential problems, then the issue would be addressed.

## **F.2 - Review that firms have put in place appropriate processes for reviewing their “policy” or execution policy and/or arrangements on a regular basis**

235. The review shows that almost all CAs (with the exception of SE) review that firms have put in place appropriate processes for reviewing their “policy” or execution policy and/or arrangements on a regular basis.

236. 17 CAs (AT, BG, CY, CZ, DE, DK, FI, HU, IT, LU, LV, MT, NL, NO, PL, PT, SI) analyse firms' review processes together with monitoring arrangements, using broadly the same methods: desk-based supervision, on-site inspections and - in some cases – external auditors.

237. In few cases (EE, ES, LT), the CAs devote more effort to verify review mechanisms than monitoring mechanisms, for instance referring to the former during on-site inspections.

238. Just a few CAs aim to find out whether the execution policies have been subject to amendments. They do this either by comparing old and new versions (FI, PT), by verifying an exhaustive list of corrections and amendments made to the policy (BE), by looking at minutes of board meetings (IE, RO, SK), by scrutinizing a variety of other internal records (PT, UK), or by reviewing regular reporting by firms on any amendment to their internal procedures. In the UK, functioning of monitoring and review of execution policy can be checked within both firm-specific and thematic supervision. Detection of shortcomings is followed by supervisory recommendations that place the burden of assuring compliance on the firm's internal audit function.

239. As mentioned above, in LI the CA stated that it does not itself review that firms have put in place processes for reviewing their execution policy and/or arrangements on a regular basis, on the basis of market specificities. In SE, in line with its risk-based approach, the CA does not review that firms have put in place appropriate processes for reviewing their execution arrangements on a regular basis.

### **F.3 - Reviews in light of a ‘material change’ that affects the firm’s ability to achieve the best possible result for its clients on a consistent basis**

240. Generally, identification of “material change” does not seem to be the focus of supervisory authorities. Some CAs (CY, EL, FR, IT, LV) when replying to the relevant question in the Review Panel questionnaire merely referred to answers to the previous questions<sup>36</sup>. Many CAs seem to review this area just like other areas within best execution, whether only through analysis of documents or also other methods.
241. An argument can be made that some CAs concentrate on annual reviews of the execution policy, not giving much consideration to “material changes” that could prompt an additional review.
242. Only 9 CAs (DE, DK, EE, ES, FI, IE, NL, SI, UK) specifically referred to methods of supervising firms’ arrangements related to identification of a “material change” and amendment of their policies.
243. A simple tool of a questionnaire is used in SI (AT uses it for all the issues related to monitoring and review), while in EE, the CA requires from firms a special analysis document.
244. In NL and DK, the CAs require that firms’ internal documents include a definition of “material change”, which may, but does not have to, differ according to class of instrument. Similarly, in BE, the CA expects firms to have a system of "warning lights" that identify the necessity to carry out a review of the policy and/or operational procedures.
245. 4 CAs (FI, IE, IT, UK) specifically question firms whether they identified any material changes and whether these caused a review of policies, and in FI, the CA also checks whether some important market developments have triggered a review.
246. Most CAs were silent on whether they check if material change is defined differently depending on class of instruments. Such a check is conducted by 8 CAs (CY, FR, IE, IT, NL, PT, SI, SK).
247. In DE the external auditor has to examine significant changes in the enterprise’s business model or in the market environment during the year, and whether the investment services enterprise has reviewed its execution policy in a timely manner and adapted it if necessary.
248. In SE, the CA does not assess whether firms have put in place appropriate processes for reviewing their policies and arrangements in light of a material change that affect the firms’ ability to achieve the best possible result on a consistent basis.

### **F.4 - Checking whether the firm’s monitoring techniques vary according to instrument type or order type**

249. Most CAs check whether the firm’s monitoring techniques vary according to instrument type or order type, whilst 3 CAs (LI, MT, SE) did not demonstrate their ability to do so.

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<sup>36</sup> For at least some CAs this probably reflects misinterpretation of the question F.c (as essentially repeating question F.a).

250. In FI, such aspect is included under the general CA's supervisory approach to best execution, without any special attention. Methods used are then the same as for other elements.
251. However, in 7 CAs (CZ, FR, IE, IT, RO, SI, UK) employ specific methods for this issue. In IT the CA expects additional monitoring and measures when it comes to illiquid instruments, and undertook more intense supervisory and enforcement actions in this area, including by conducting thematic reviews and numerous onsite inspections. In the UK, the CA does this mostly via desk-based review of documentation, first of quality analysis, then of records of transactions if needed. In CZ and RO, the CAs use inspections to scrutinize firms' data processing systems. In IE and SI, the CAs use questionnaires that include questions on differentiation. In IE, the CA follows up on the questionnaire with additional information requests.
252. As mentioned above, in IE, the CA has also issued a letter to industry containing findings of its review.

## 4 – Identified challenges

### 4.1 - Main challenges in the supervision of arrangements and policies

253. One main challenge is seen by some CAs (EE, ES, LI, LU, NO, NL) when it comes to the review of an investment firm's assessment that the chosen execution method and venue was in the client's best interest. CAs reported that it is difficult to assess whether the right numbers are used in calculations or arguments for choosing a specific route. The lack of standardised data, including a consolidated tape and accurate time-stamping are significant limitations to the ease with which best price can be demonstrated. A lack of harmonised calculation methodologies for existing benchmarks also limits CA's ability to assert 'unreasonable' conduct by firms. Conversely, the essentially qualitative nature of the obligation arguably means that such limitations are inherent.

254. The CA of FR mentions that the main difficulties are linked to certain imprecision in the European texts which generate significant gaps in different firms' implementation of their obligations. Furthermore, the regulation does not always take into consideration the diversity of financial instruments, nor of the numerous ways they can be negotiated. As a result of these uncertainties, some firms may either be lost, or take advantage of these uncertainties to circumvent their best execution obligations.

255. Another challenge (LI, UK) is seen in the assessment whether execution policies are capable of achieving best execution when trading takes place off-exchange, for example on MTF dark pools.

### 4.2 - Main challenges in the supervision of best execution disclosure and consent

256. The supervision of the disclosure and consent to best execution provides several challenges to CAs. Some (7) CAs (CZ, FR, IT, LU, NL, RO, UK) observed that the limited knowledge of investors about Best Execution provided a challenge in assessing the appropriateness of the information and the procedures through which it was provided. This challenge was further enhanced by the lack of a definition of 'adequate disclosure' to clients (IE, LV, UK).

257. Other challenges named by CAs were: a subsequent assessment on whether clients have been provided with necessary information (FI, FR, IT, LT), a lack of awareness of credit institutions about their obligations (AT), the supervision of actual application of Best Execution procedures (EL), ensuring entities work for clients' best interest (ES), a lack of detail in best execution disclosures (BE), a consistent application of Best Execution rules (EE).

258. 8 CAs (BG, DE, LI, SK, SI, NO, PT) said that they had no challenges in the supervision of best execution disclosure and consent, whilst 3 CAs stated that they had not sufficient experience to comment (CY, DK, SE).

### 4.3 - Main challenges in the supervision of the firm's ability to demonstrate adherence to

## **best execution policy**

259. Not all of the CAs have provided indications on major challenges encountered on the issue. It has to be underlined that the challenges identified by the responding authorities are very different from one to another.
260. The most commonly mentioned challenge is related to the provision of data relating to the decisions which have been taken, the price comparisons and/or the monitoring of their obligation by firms. This lack of data can be due to the fact that the data cannot be obtained (on bond market for instance), that the processes are not formalized by firms or that the audit trail is not kept (IE, FI, LU). This difficulty can also result in a poor capacity of the firm to demonstrate to its clients that their orders have been executed in a way which is consistent with the best execution policy of the firm and thus a greater role should be assigned to the compliance officers of investment firms (EL) or in a lack of details (IT) of the answers provided to the questions addressed by the CA in the periodic reporting.
261. Other authorities consider that the crucial challenge relates to the organization of their national market, as explained below.
262. The limited liquidity of the national market can make the implementation of the best execution requirements difficult (CZ). A small number of trading venues can have the same consequences (RO).
263. On the contrary, the CA of PT considers that a limited number of trading venues is diminishing the difficulty of the implementation and monitoring of the best execution policy, because the difficulty comes from the sophistication of the markets, which offers the possibility to make different choices.
264. Lastly, the CA of LI indicates that the challenge comes from the fact that their national market is constituted of small asset management firms, which only rely on the execution policy of the custodian bank of their clients.
265. The other challenges reported by authorities are very different from one another. The following can be mentioned:
- Staff training of investment firms regarding communication with clients and their control should be improved (SK);
  - The supervisor cannot intervene in the discretionary choice made by the firm (BE);
  - The comprehension of the policy by the clients is not assured (RO).

# Annex I - Self assessment questionnaire

## Review Panel Peer Review on Best Execution under MiFID

### Introduction

1. In May 2013, the ESMA Board of Supervisors mandated the Review Panel to carry out a peer review regarding the obligation to execute orders on terms most favourable to the client (best execution) under article 21 of MiFID and its implementing provisions (Annex 1). The work will investigate how the EEA national competent authorities, who are represented in the ESMA Review Panel, nationally undertake their tasks with regard to the supervision and enforcement of the MiFID provisions on best execution.

### Purpose of this document

2. In accordance with the Review Panel Methodology (ESMA/2012/33), this document sets out the peer review self- assessment questionnaire that members will fill in using the ESMA Survey IT-tool. The purpose of the questionnaire is to capture the different ways competent authorities supervise and enforce the various dimensions of the best execution rule. The questions specifically address each of these dimensions, which will help to demonstrate the overall approach to supervision of best execution. The Review Panel will use the information gathered by this questionnaire to inform its report in order to facilitate the objective of supervisory convergence.
3. Competent Authorities shall provide detailed description, reasoning and evidence supporting their responses. The types of evidence which may be provided includes all information described in par. 61 of the peer review methodology (including, but not limited to, the indicative list in the appendix to the methodology). Responses to this questionnaire and relevant supporting material will be kept confidential.
4. Peer Reviews need to assess:
  - the independence of competent authorities and their capacity, through the adequacy of their resources and governance arrangements, to achieve high quality supervisory outcomes and to respond to market developments,
  - the degree of convergence reached in the application of Union law and in supervisory practice and the extent to which the supervisory practice achieves the objectives set out in Union law,
  - the effectiveness and the degree of convergence reached in the ability to take actions with regard to the provisions adopted in the implementation of Union law, including the administrative measures and sanctions imposed against persons responsible where those provisions have not been complied with.
5. This document establishes assessment criteria and sets the relevant benchmarks. Competent Authorities are expected to explain in an open dialogue with the RP team the grounds for their answers by giving a self-assessment of their perceived weak and strong points.
6. The Key Issues, Key Questions and Benchmarks aim at enabling the Review Panel to assess how

Competent Authorities actively apply, supervise and enforce best execution. The Benchmarks are not intended to be a checklist for Competent Authorities and assessors, nor shall the peer review be seen, or presented as a box-ticking exercise. The assessment will be the outcome of an overall analysis based on the information provided in responding to the questionnaire, taking into account proportionality and market specificities. The assessment is not an end in itself, but rather a step for identifying potential areas where further efforts may be needed in the process of enhancing supervisory convergence.

7. The Key Issues have been developed largely on the basis of the MiFID Supervisory Briefings – Best Execution (Ref. CESR/08-735) and ESMA Q&A on Best Execution under MiFID of May 2007 (Ref. CESR/07-320). The Key Issues shall not be interpreted as demanding any particular way of supervision, or as limiting the specific techniques or actions that Competent Authorities may undertake to achieve compliance with best execution.
8. The review period shall be from 1 January 2011 to 31 December 2012. For later developments, please use the text boxes.

#### **Instructions to fill in the questionnaire**

9. A number of Key Questions are structured as yes or no questions. After responding to these questions, please fill in the “text” box in order to provide details supporting your response (including specific cross-references to the written material and other supporting information you will enclose pursuant to par. 3 above). Where necessary, open questions are included to ensure sufficiently detailed information gathering and appropriate description of supervisory and enforcement practices.
10. Certain Key Questions are non-specifically benchmarked or may include non-specifically benchmarked sub-questions requesting additional information on specific topics. The purpose of these questions is to favour a more in-depth analysis on how best execution is supervised and enforced, with a view to assessing the degree of convergence across the EU and possibly identify good practices which might be of benefit for competent authorities (see art. 30 of ESMA Regulation and par. 51 of the peer review methodology). If you wish to provide additional information on any of these subject matters, please fill the “other” box.
11. Please provide your replies to the questionnaire by 20 September 2013.

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## A. Background information

12. In order to provide some background on your market size and general supervisory approach, please respond to the following questions:

- a) Please update, if needed, the figures in the tables under Annex 2 from the Mapping Report - MiFID CoB on information in order to provide us with the number of investment firms and credit institutions subject to the best execution rule authorised in your jurisdiction (text box)
- b) In the subject matter, do you share competences with other national authorities<sup>37</sup>? (Y/N)
- c) If yes please provide details on respective roles/ functions and means for coordination (text box)
- d) Please provide the following information on how the competent authority(ies) is (are) internally structured to supervise, inspect and enforce the application of MiFID obligations, including best execution by investment firms:
  - a. a general description of the units involved and resources applied, including staff (text box),
  - b. the operation of internal governance and oversight, including a description of the main steps in relevant decision making processes in each of the stages of (i) supervision, (ii) inspection and (iii) enforcement of best execution (text box).
- e) Please describe in summary what is your supervisory approach to supervise compliance with best execution, including, where relevant, local market specificities explaining it? (text box)

## B. Organisation and general supervisory approach

### Key issues

13. Competent authorities should set out their approach to supervision of best execution<sup>38</sup> which should

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<sup>37</sup> In case the ESMA member shares competences with another domestic regulator the responses to all relevant questions should include the relevant rules and practice. The outcome of the exercise shall refer to the implementation at the level of each country. The explanatory text to the assessment shall provide sufficient explanation to make the assessment understandable.

<sup>38</sup> Article 21 of MiFID L1 states that "investment firms 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".

Articles 44 and 46 of Level 2 set out the requirements for investment firms that provide the service of executing orders on behalf of clients for MiFID financial instruments and, indirectly via article 45(7), for investment firms that provide the service of portfolio management, when executing decisions to deal on behalf of client portfolios.

Article 45 of Level 2 sets out the requirements for: (i) investment firms that provide the service of reception and transmission of orders, when transmitting orders to other entities for execution and (ii) investment firms that provide the service of portfolio management, when placing orders with other entities for execution that result from decisions to deal in financial instruments on behalf of client portfolios. There are associated recitals in both Level 1 and Level 2 (Recital 33 of Level 1, and Recitals 66 to 76 of Level 2).



be clearly communicated internally. Supervision of best execution can be part of their overall approach to supervision of investment firms under MiFID. As such, it is not expected that competent authorities would necessarily have a specifically tailored approach in relation to the supervision of compliance by firms with best execution rules.

14. Competent authorities should have an internal organisation to ensure that the supervision of best execution as part of supervision of conduct of business activities is conducted in a coherent and consistent way over the time and across teams involved.
15. The supervision of best execution practices should be part of the established organisational structures, procedures and resources of the competent authorities. These organisations, procedures and resources involved should allow appropriate supervision and enforcement.
16. Competent authorities should have a clear approach setting out how they supervise compliance with best execution and when and how to undertake actions. These criteria may be the same generally identified for the supervision of MiFID provisions and may result in the application of a range of supervisory tools and approaches available to competent authorities, dependent on the circumstances. As a minimum, these criteria should include the following factors:
  - (i) scale of activities or volume of investment products covered;
  - (ii) volume of complaints and alerts received;
  - (iii) indicators from the regular review of audit report or indicators from the review of information and data transmitted by investment firms;
  - (iv) nature of complaints and alerts received;
  - (v) type of products.
17. Competent authorities should actively monitor on a desk-based basis that firms have put in place and apply best execution policy and arrangements. Relevant sources should include at least periodic reporting by firms or by independent external auditors, information by investment firms, investors' complaints, and where available information from other competent authorities. Competent authorities shall carry out their own assessment on compliance with best execution, without relying exclusively on external sources, such as independent auditors or experts, in the performance of their functions.
18. Competent authorities should plan and carry out periodically on-site inspections on MiFID provisions, including best execution, where appropriate. Competent authorities should have criteria in place to decide on when to undertake on-site inspections, either on a periodic or a non-routine basis, determined by a range of potential factors (e.g. the overall risk profile of the firm, specific market intelligence, the time of the last visit, etc.). Competent authorities should always be able to conduct non routine on-site inspections on best execution.
19. Competent authorities should be able to conduct face-to-face meetings with and hearings of senior managers of investment firms to assess compliance with MiFID provisions, including best execution, where appropriate.
20. Competent authorities should have an approach to determine where undertaking thematic work,

whether specifically on best execution or with a broader focus, may be appropriate. Thematic work may address, for example, common practice in a sector rather than regulating individual firms. It may be based on an assessment of the risks in the relevant market; how the market reacted to new legislation; or to other relevant developments and innovations.

21. The tools and approaches mentioned in paragraphs 5 to 8 are complementary and, keeping in mind the proportionality principle and in order to adapt the resources employed to the risks identified may not be simultaneously implemented for all the firms supervised. In any case, competent authorities should be able to demonstrate that the range of tools employed, the coverage and intensity of their actions ensure effective supervision and, where risk models are used, that risk analysis are appropriately tested.
22. In the case of breaches of relevant rules, competent authorities should take appropriate, necessary and proportionate binding enforcement actions.

#### *Key Questions*

- a) Is your supervisory approach to best execution as part of conduct of business supervision clearly communicated internally? **(Y/N)**

Please describe briefly your approach and general strategy on supervision of best execution as part of conduct of business supervision and explain the means whereby it is communicated internally **(text box)**

- b) Do you have a database allowing efficient internal sharing and processing of intelligence or other sources supporting supervision of best execution as part of conduct of business supervision? **(Y/N)**

Please describe how it works, the main information and intelligence included (relevant to best execution) and how it supports you in the supervision of best execution as part of conduct of business supervision **(text box)**

- c) Do you organise meetings across different sections / teams involved on application of MiFID rules, including on best execution on a regular basis? **(Y/N)**

Please describe how this information flow is structured **(text box)**

- d) Do you have in place any other mechanism to achieve effective communication across different sections / teams involved? **(Y/N)**

Please explain **(text box)**

- e) Is the supervision of the rules of conduct including best execution practices part of your established organisational structures, procedures and resources in a way that allow appropriate

supervision and enforcement? **(Y/N)**

Please provide details on how this is achieved **(text box)**

- f) Do you have a clear approach setting out when and how you supervise compliance with conduct of business rules including best execution and when and how you undertake actions? **(Y/N)**

Please provide the factors that are taken into account and how they are used to determine the triggering of supervisory actions **(text box)**

- g) Does this approach include at least the following minimum factors:
- (i) scale of activities or volume of investment products covered; **(Y/N)**
  - (ii) volume of complaints and alerts received; **(Y/N)**
  - (iii) indicators from the regular review of audit report or indicators from the review of information and data transmitted by investment firms; **(Y/N)**
  - (iv) nature of complaints and alerts received; **(Y/N)**
  - (v) type of products **(Y/N)**

Please explain **(text box)**

- h) Do you actively monitor compliance with best execution, including through desk-based reviews? **(Y/N)**

What are the frequency, intensity and coverage of these reviews? **(text box)**

- i) Do you include the following sources in your desk-based review?
- (i) periodic reporting by firms or by independent external auditors **(Y/N)**
  - (ii) information by investment firms, investors' complaints **(Y/N)**
  - (iii) where available, information from other competent authorities **(Y/N)**

Please explain **(text box)**

Are your desk-based reviews triggered by any other sources of information? **(text box)**

- j) Do you undertake on-site inspections to monitor compliance with conduct of business obligations including best execution? **(Y/N)**

Please explain and describe the relevant processes / approaches, including how you select firms and frequency of on-site inspections, and provide examples of relevant on-site inspections carried out during the review period, if any **(text box)**

- k) Are you able to conduct non routine on-site inspections to monitor compliance with conduct of business obligations including best execution? **(Y/N)**

Please explain **(text box)**

- l) Do you organise, where appropriate, face-to face meetings with the supervised firms where compliance with best execution may be discussed as part of MiFID supervision? **(Y/N)**

Please explain, and describe relevant approaches, including examples of relevant meetings carried out during the review period, if any **(text box)**

- m) Do you undertake thematic work, dedicated or otherwise where best execution may be included as part of MiFID supervision? **(Y/N)**

Please explain, and describe relevant approaches, including examples of thematic work carried out during the review period, if any **(text box)**

- n) Are you able to demonstrate that the range of tools you employ, the coverage and intensity of your actions ensure effective supervision of best execution and that, where risk models are used, risk analysis are appropriately tested? **(Y/N)**

Please describe **(text box)**

- o) In order to help firms to better implement best execution requirements, have you developed working groups, communications, best practices guides, Q&A or similar initiatives on best execution?

If yes, please describe **(text box)**

- p) Have you detected violations of best execution and taken enforcement actions during the review period? **(Y/N)**

If yes, what enforcement actions have you taken? **(text box)**

### *Benchmarks*

**Fully applied** (*signifies the achievement of high quality supervisory outcomes, to which other authorities should converge*)

This assessment is awarded if a positive answer is given to:

questions a) and b), or  
questions a) and c), or  
questions a) and d),  
and to questions e) to n).

**Partially applied** (*signifies that more convergence in supervisory practices and outcomes is required to achieve the objectives set out in the MiFID provisions on Best Execution*)

This assessment is awarded if a positive answer is given to questions a), to questions e) to h) and to question j), and a negative answer is given to questions b), c), d), i), k), l), m) and/or n).

**Not applied** (*signifies that the convergence in supervisory practices and outcomes is insufficient to achieve the objectives set out in the MiFID provisions on Best Execution*)

This assessment is awarded if a negative response is given to any of questions a), or questions e)



to h) or question j).

## C. Supervision of arrangements and policies

### *Key issues*

23. Competent authorities should assess whether firms put in place arrangements for best execution and a policy which summarises those arrangements<sup>39</sup>. Competent authorities should check that the execution policy:
  - includes the key steps the firm is staking to comply with the best execution and how those steps enable the firm to obtain the best possible result;
  - takes into account the relative importance, or the process for determining the relative importance, the firm places on the execution factors;
  - describes how those factors affect the firm's choice of execution venues or entities to which it transmits orders;
  - sets out those venues the firm uses to execute orders or decisions to deal, and/or entities to which it transmits orders or decisions to deal for execution; and
  - is differentiated in order to reflect at least any important variation in the way that orders for different types of clients and different classes of financial instruments are executed or transmitted.
24. Competent authorities should request information from firms where the need for further clarification is identified.
25. Competent authorities should review whether firms are able to identify the persons responsible for developing the arrangements and policy for executing, or transmitting, orders or decisions to deal.
26. Competent authorities should review that the compliance function is appropriately involved in the development, application and review of the execution policy and that the execution policy is approved by the board/senior management of the firm.
27. Competent authorities should review any other relevant documentation from firms relating to executing, or transmitting orders or decisions to deal in addition to the information contained in the policy, including reports by the compliance function on how the execution policy is working in practice.
28. Competent authorities should assess whether the processes used by the firms to select the venues/entities included in the “policy” (for firms transmitting client orders or decisions to deal) or execution policy (for firms that execute) are capable of achieving compliance with their best execution obligations.
29. Competent authorities should review how firms assess the relative importance of the best execution factors in order to enable them to obtain the best possible result on a consistent basis.

### *Key questions*

- a) When assessing that firms put in place arrangements for best execution and a policy which

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<sup>39</sup> Please refer to Q&A on best execution no. 5 as regards the difference between “execution arrangements” and “execution policy”.

summarises those arrangements, do you check that the execution policy is compliant with MiFID requirements, taking into account the specificities of the firm controlled? **(Y/N) Y**

Please explain how you carry out these checks in practice and in particular whether you check that the policy:

- includes the key steps the firm is taking to comply with the best execution and how those steps enable the firm to obtain the best possible result on a consistent basis;
- takes into account the relative importance, or the process for determining the relative importance, the firm places on the execution factors;
- describes how those factors affect the firm's choice of execution venues or entities to which it transmits orders;
- sets out those venues the firm uses to execute orders or decisions to deal, and/or entities to which it transmits orders or decisions to deal for execution; and
- is differentiated in order to reflect at least any important variation in the way that orders for different types of clients and different classes of financial instruments are executed or transmitted? **(text box)**

- b) Do you review whether firms are able to identify the persons responsible in developing the arrangements and policy for executing, or transmitting, orders of decisions to deal? **(Y/N)**

Please explain how **(text box)**

- c) Do you review that the firm's compliance function is appropriately involved in the development and application of the execution policy and that the execution policy is approved by the board/senior management of the firm? **(Y/N)**

Please explain how you do it in practice **(text box)**

- d) Do you review any other documentation from firms relating to executing, or transmitting orders or decisions to deal in addition to the information contained in the policy, including reports by the compliance function on how their execution policy is working in practice? **(Y/N)**

Please explain how you carry out this review and how frequently **(text box)**

- e) Do you review whether the processes used by the firms to select the venues/entities included in the "policy" (for firms transmitting client orders or decisions to deal) or execution policy (for firms that execute) are capable of achieving compliance with the best execution? **(Y/N)**

Please explain how you do it in practice and describe any differences or challenges depending on the class of instruments considered **(text box)**

- f) Do you review how the firm assesses the relative importance of the best execution factors in order to obtain the best possible result on a consistent basis? **(Y/N)**

Please explain how you do it in practice and describe any differences or challenges depending on

the class of instruments considered (**text box**)

- g) In your experience, what are the main challenges in the supervision of best execution arrangements and policies?

#### *Benchmarks*

**Fully applied** (*signifies the achievement of high quality supervisory outcomes, to which other authorities should converge*)

This assessment is awarded if a positive answer is given to questions a) to f).

**Partially applied** (*signifies that more convergence in supervisory practices and outcomes is required to achieve the objectives set out in the MiFID provisions on Best Execution*)

This assessment is awarded if a positive answer is given to questions a) and c), and a negative response is given to questions b), d), e), f) and/or g).

**Not applied** (*signifies that the convergence in supervisory practices and outcomes is insufficient to achieve the objectives set out in the MiFID provisions on Best Execution*)

This assessment is awarded if a negative response is given to any of questions a), or c).



## D. Supervision of disclosure and consent

### *Key issues*

30. Competent authorities should review that firms provide appropriate information to retail clients to enable an adequate understanding about the key aspects of the firm's execution policy (for firms that execute) or "policy" (for firms that transmit orders or decisions to deal) in good time prior to the provision of the service in a durable medium or by means of a website under certain conditions, including:
- the relative importance the firms assigns to best execution factors or the process by which it determines their relative importance,
  - a list of the execution venues/entities used on which the firm places significant reliance in meeting the overarching execution requirement;
  - a warning to the client regarding the use of specific instructions.

Moreover, competent authorities should review that the above-mentioned information is in fact disclosed to the retail clients.

31. Competent authorities should review whether any additional information about the execution policy of a firm which executes orders or decisions to deal is disclosed to the firm's retail clients as a matter of course or upon request.
32. Competent authorities should consider whether the firm has set up appropriate arrangements and procedures (or other measures) to collect clients' consent.

### *Key questions*

- a) Do you review that firms provide appropriate information to retail clients to enable an adequate understanding about the key aspects of the firm's execution policy (for firms that execute) or "policy" (for firms that transmit orders or decisions to deal) in good time prior to the provision of the service in a durable medium or by means of a website under certain conditions, including:
- o the relative importance the firms assigns to best execution factors or the process by which it determines their relative importance,
  - o a list of the execution venues/entities used on which the firm places significant reliance in meeting the overarching execution requirement;
  - o a warning to the client regarding the use of specific instructions? **(Y/N)**

Please explain how you do it in practice **(text box)**

- b) Do you review that the above-mentioned information is in fact disclosed to the clients? **(Y/N)**

Please explain how you do it in practice and whether there are any differences depending on the classes of instruments concerned **(text box)**

- c) Do you review that any additional information about the execution policy of firms which execute orders or decisions to deal is disclosed to the firms' retail clients as a matter of course or upon request? **(Y/N)**

Please explain how you do it in practice **(text box)**

- d) Do you check that firms set up appropriate arrangements and procedures (or other measures) to collect clients' consent? **(Y/N)**

Please explain how you do it in practice **(text box)**

- e) In your experience, what are the main challenges in the supervision of best execution disclosure and consent?

#### *Benchmarks*

**Fully applied** (*signifies the achievement of high quality supervisory outcomes, to which other authorities should converge*)

This assessment is awarded if a positive answer is given to questions a) to d).

**Partially applied** (*signifies that more convergence in supervisory practices and outcomes is required to achieve the objectives set out in the MiFID provisions on Best Execution*)

This assessment is awarded if a positive answer is given to questions a) and d) and a negative response is given to questions b) and/or c).

**Not applied** (*signifies that the convergence in supervisory practices and outcomes is insufficient to achieve the objectives set out in the MiFID provisions on Best Execution*)

This assessment is awarded if a negative response is given to any of questions a) or d).

## **Supervision of ability to demonstrate adherence to policy**

### *Key Issues*

33. Where appropriate, competent authorities should review investment firms' procedures and arrangements for demonstrating, at a client's request, that they have executed any individual order or decision to deal in compliance with their execution policy. For this purpose, where the firm has only one execution venue listed in its execution policy for a particular type of financial instrument, competent authorities should review that the firm is able to demonstrate that it can obtain the best possible result on a consistent basis.

### *Key Questions*

- a) Do you review firms' procedures and arrangements for demonstrating, at a client's request, that they have executed any individual order or decision to deal in compliance with their execution

policy? **(Y/N)**

Please explain how you carry out this review and how frequently **(text box)**

- b) Where the firm has only one execution venue listed in its execution policy for a particular type of financial instrument, do you review that the firm is able to demonstrate that it can obtain the best possible result on a consistent basis? **(Y/N)**

Please explain how you do it in practice **(text box)**

- c) In your experience, what are the main challenges in the supervision of the firms' ability to demonstrate adherence to best execution policy? **(text box)**

#### *Benchmarks*

**Fully applied** (*signifies the achievement of high quality supervisory outcomes, to which other authorities should converge*)

This assessment is awarded if a positive answer is given to questions a) and b), or if a positive answer is given to questions a) and question b) is not applicable (no firms with only one execution venue are supervised).

**Partially applied** (*signifies that more convergence in supervisory practices and outcomes is required to achieve the objectives set out in the MiFID provisions on Best Execution*)

This assessment is awarded if a positive answer is given to question a) and a negative response is given to question b).

**Not applied** (*signifies that the convergence in supervisory practices and outcomes is insufficient to achieve the objectives set out in the MiFID provisions on Best Execution*)

This assessment is awarded if a negative response is given to question a).

## **F. Supervision of ability to monitor and review**

### *Key Issues*

34. Competent authorities should assess whether firms have put in place appropriate processes to monitor, on a regular basis, the effectiveness of its arrangements and policy to deliver the best possible result for its client on a consistent basis and, where appropriate, correct any deficiencies.
35. Competent authorities should review that firms have put in place appropriate processes for reviewing their "policy" or execution policy and/or arrangements on a regular basis.
36. Competent authorities should review that firms have processes in place to determine whether a review of their policies or arrangements is needed in light of a 'material change' that affects the firm's ability to achieve the best possible result for its clients on a consistent basis.
37. Competent authorities should check whether the firm's monitoring techniques vary according to

instrument type or order type.

### *Key Questions*

- a) Do you review that firms have put in place appropriate processes to monitor, on a regular basis, the effectiveness of its arrangements and policy to deliver the best possible result for its clients on a consistent basis and, where appropriate, correct any deficiencies? **(Y/N)**

Please explain how do you do it **(text box)**

- b) Do you review that firms have put in place appropriate processes for reviewing their “execution policy and/or arrangements on a regular basis? **(Y/N)**

Please explain how do you do it **(text box)**

- c) Do you review that firms have processes in place to enable them to determine whether a review of their policies or arrangements is needed in light of a ‘material change’ that affects the firm’s ability to achieve the best possible result for its clients on a consistent basis? **(Y/N)**

Please explain how do you do it and whether there are any differences depending on the particular class of instrument concerned **(text box)**

- d) Do you check whether the firms’ monitoring techniques vary according to instrument type or order type? **(Y/N)**

Please explain how do you do it **(text box)**

- e) In your experience, what are the main challenges in the supervision of the firms’ ability to monitor and review best their execution policy? **(text box)**

### *Benchmarks*

**Fully applied** (*signifies the achievement of high quality supervisory outcomes, to which other authorities should converge*)

This assessment is awarded if a positive answer is given to questions a) to d).

**Partially applied** (*signifies that more convergence in supervisory practices and outcomes is required to achieve the objectives set out in the MiFID provisions on Best Execution*)

This assessment is awarded if a positive answer is given to questions a) and d), and a negative response is given to questions b) and/or c).

**Not applied** (*signifies that the convergence in supervisory practices and outcomes is insufficient to achieve the objectives set out in the MiFID provisions on Best Execution*)

This assessment is awarded if a negative response is given to any of questions a) or d).

## Annex II– MiFID provisions on best execution

### Article 21 MiFID

1. Member States **shall require that investment firms 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.** Nevertheless, whenever there is a specific instruction from the client the investment firm shall execute the order following the specific instruction.

2. Member States **shall require investment firms to establish and implement effective arrangements** for complying with paragraph 1. In particular Member States shall require investment firms to **establish and implement an order execution policy** to allow them to obtain, for their client orders, the best possible result in accordance with paragraph 1.

3. The order execution policy shall include, in respect of each class of instruments, information on the different venues where the investment firm executes its client orders and the factors affecting the choice of execution venue. It shall at least include those venues that enable the investment firm to obtain on a consistent basis the best possible result for the execution of client orders.

Member States shall **require that investment firms provide appropriate information** to their clients on their order execution policy. Member States shall require that investment firms obtain the prior consent of their clients to the execution policy.

Member States shall require that, where the order execution policy provides for the possibility that client orders may be executed outside a regulated market or an MTF, the investment firm shall, in particular, **inform** its clients about this possibility. Member States shall require that investment firms obtain the prior express consent of their clients before proceeding to execute their orders outside a regulated market or an MTF. Investment firms may obtain this consent either in the form of a general agreement or in respect of individual transactions.

4. Member States shall require investment firms to **monitor the effectiveness** of their order execution arrangements and execution policy in order to identify and, where appropriate, correct any deficiencies. In particular, they shall **assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best possible result for the client or whether they need to make changes to their execution arrangements.** Member States shall require investment firms to notify clients of any material changes to their order execution arrangements or execution policy.

5. Member States shall require investment firms to be **able to demonstrate to their clients, at their request,** that they have executed their orders in accordance with the firm's execution policy.

6. In order to ensure the protection necessary for investors, the fair and orderly functioning of markets, and to ensure the uniform application of paragraphs 1, 3 and 4, the Commission shall, in accordance with the procedure referred to in Article 64(2), adopt implementing measures concerning:

(a) the criteria for determining the relative importance of the different factors that, pursuant to paragraph

1, may be taken into account for determining the best possible result taking into account the size and type of order and the retail or professional nature of the client;

(b) factors that may be taken into account by an investment firm when reviewing its execution arrangements and the circumstances under which changes to such arrangements may be appropriate. In particular, the factors for determining which venues enable investment firms to obtain on a consistent basis the best possible result for executing the client orders;

(c) the nature and extent of the information to be provided to clients on their execution policies, pursuant to paragraph 3.

#### **Article 44 of the Commission directive 2006/73**

1. Member States shall ensure that, when executing client orders, investment firms take into account the following criteria for determining the **relative importance** of the factors referred to in Article 21(1) of Directive 2004/39/EC:

(a) the characteristics of the client including the categorisation of the client as **retail or professional**;

(b) the characteristics of the client order;

(c) the characteristics of financial instruments that are the subject of that order;

(d) the characteristics of the execution venues to which that order can be directed.

For the purposes of this Article and Article 46, 'execution venue' means a regulated market, an MTF, a systematic internaliser, or a market maker or other liquidity provider or an entity that performs a similar function in a third country to the functions performed by any of the foregoing.

2. An investment firm satisfies its obligation under Article 21(1) of Directive 2004/39/EC to take all reasonable steps to obtain the best possible result for a client to the extent that it executes an order or a specific aspect of an order following specific instructions from the client relating to the order or the specific aspect of the order.

3. Where an investment firm executes an order on behalf of a **retail client**, the best possible result shall be determined in terms of the total consideration, representing the price of the financial instrument and the costs related to execution, which shall include all expenses incurred by the client which are directly related to the execution of the order, including execution venue fees, clearing and settlement fees and any other fees paid to third parties involved in the execution of the order.

For the purposes of delivering **best execution where there is more than one competing venue to execute an order for a financial instrument**, in order to assess and compare the results for the client that would be achieved by executing the order on each of the execution venues listed in the firm's order execution policy that is capable of executing that order, the firm's own commissions and costs for executing the order on each of the eligible execution venues shall be taken into account in that assessment.

4. Member States shall require that investment firms do not structure or charge their commissions in



such a way as to discriminate unfairly between execution venues.

5. Before 1 November 2008 the Commission shall present a report to the European Parliament and to the Council on the availability, comparability and consolidation of information concerning the quality of execution of various execution venues.

## Annex III - Statements from on-site visited CAs to the MiFID Best Execution peer review report

- **Statement by CSSF**

The CSSF underlines that from 2009 to 2012, it has performed 15 onsite inspections covering only MiFID CoB rules. Bearing in mind that the CSSF has chosen a holistic approach which covers best execution, but is not limited to best execution, and the fact that it has required investment firms to amend their MiFID CoB arrangements, the CSSF believes that its approach is appropriately balanced and cannot be said to solely rely on the work performed by the external auditor.

When performing on-site inspections the CSSF systematically examines the quality of order execution and the choice of the execution venues through a sample of client orders in order to verify that the client obtained the best possible result. A sample of client orders thus examined has been forwarded to the ESMA visiting team. Moreover, it should be noted that for retail clients, the best possible result is determined in terms of the total consideration (cf. CESR Q&A Best execution under MiFID - Question 10.2 and article 44 (3) MiFID Implementing Directive 2006/73/EU).

The thematic review performed by the CSSF is in line with the description contained in paragraph 20 of the ESMA questionnaire of 24 July 2013 (ESMA/2013/BS/111).

The CSSF regrets that the points above have not been reflected in the otherwise very valuable report and therefore have to be restated.

- **Statement by FMA**

Liechtenstein's implementation of MiFID was fully approved by the EFTA Surveillance Authority, including the provisions on best execution. ESMA's remark refers to the asset management firms, which may provide a subset of investment services of the Directive 2004/39/EC. Asset managers are not allowed to accept or hold client money. The clients' assets are held in safekeeping accounts at credit institutions. The asset manager acts on a contractual basis (limited power of attorney to provide portfolio management). Best execution is fully applied at the level of the credit institution where the transaction is effectively executed and where the client's assets are safe kept.

The reservations in the report about the use of external audit firms should be counterbalanced by the positive aspects. The audits by external auditors represent the basis level of supervision. External auditors are a proven and effective measure to leverage the limited resources of a supervisory authority. They allow yearly audits on MiFID provisions. This basis level is complemented by several other supervisory tools which are applied independently from the audit firms directly by the FMA.

Furthermore, it should be noted that the use of selected audit firms is due to a legal provision in the local legal framework. It is not a supervisory approach adopted by the FMA but a legal necessity.

- **Statement by KNF**

The KNF is of the view that assessment included in the Peer Review Report (the "Report") does not fully reflect the specificities of the Polish securities market. The KNF disagrees with the interpretation of facts provided in the Report as it does not take into account some of the explanations submitted in response to the questionnaire. The above has a significant impact on the conclusions of the Report.

On the Polish market, there are no execution venues (regulated markets, MTFs, systematic internalisers)



competing with the Warsaw Stock Exchange. ESMA is of the opinion that existence of only one trading venue for certain types of financial instruments (which enables an investment firm to execute or transmit orders to only one execution venue) does not allow to disapply best execution rules. The KNF does not share such interpretation of MiFID. Therefore, the KNF is of the view that both the regulatory provisions and supervisory practice in Poland do not provide any justification to the statement on the non - application of best execution requirements.

The KNF supervisory approach and number of employees dedicated to supervisory functions reflect financial resources of the KNF and correspond to the level of current development of capital market, especially having in mind the very limited number of orders to which the best execution requirements would apply - only 0.11% of transactions executed by investment firms in 2012.

- **Statement by MFSA**

The MFSA has carefully considered the Report on ESMA's on-site visit which reviewed the MFSA's supervisory practices on best execution. The MFSA will seek to address all the recommendations in the Report. The MFSA is in the process of setting up a Conduct Supervisory Unit, which will inter alia focus on supervisory work relating to conduct of business in terms of MiFID.

The MFSA would like to thank ESMA for its recommendations on how to strengthen its supervisory practices.