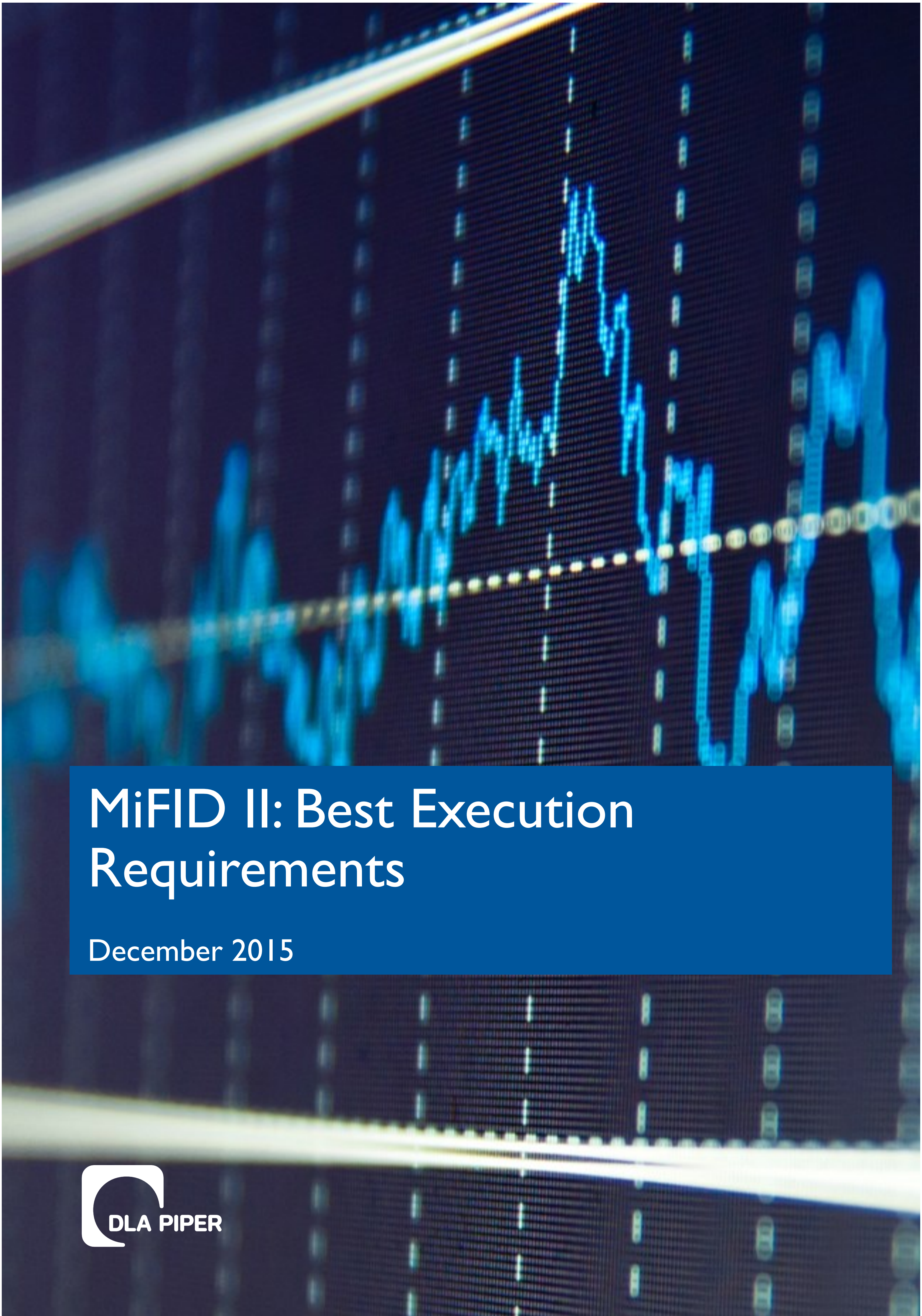

MiFID II: Best Execution Requirements

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DLA PIPER

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A. INTRODUCTION

MiFID I introduced a comprehensive best execution regime on the basis that delivering best execution is considered fundamental to market integrity. However, there was a perceived need for reform to increase investor protection given the increased range of EU execution venues and advances in monitoring technology. The approach adopted was to encourage competition, raise execution standards and increase transparency.

On 28 September 2015, ESMA published its final report on the draft RTS in relation to best execution. RTS 27 deals with the content, format and periodicity of data on execution quality, to be published by trading venues, systematic internalisers (**"SIs"**) and other execution venues. RTS 28 deals with the content and the format of information to be published by investment firms. This information includes the top five execution venues used and the quality of execution obtained.

B. BEST EXECUTION UNDER MIFID II - A RECAP

The recitals to MiFID II Directive describe an enhancement for retail investors. However, the best execution rules under Article 27 also continue to apply to professional clients (eligible counterparties remain outside the best execution rules).

MiFID II introduces several changes for investment firms executing client orders. These include:

- Trading venues (regulated markets, MTFs and OTFs), SIs, market makers or other liquidity providers are required to publish data relating to execution quality (at least annually) without charge. The information needs to include details about price, costs, speed and likelihood of execution for individual financial instruments. It should be noted that the definition of SI has been potentially widened.
- Firms will have to publish, on an annual basis, their top five execution venues, for the previous year, along with specific data relating to the quality of execution of transactions on that venue.
- Investment firms are not permitted to receive "*any remuneration, discount or non-monetary benefit for routing client orders*" to a particular trading or execution venue "*which would infringe the requirements on conflicts of interest or inducements*". Payment for order flow has already been the subject of debate in the UK and the FCA's view has been that such payments are contrary to the conflicts of interest and inducements rules.
- A firm's execution policy will have to be "*clear and sufficiently detailed*" and drafted in a way that can be easily understood by clients.
- There is an increased onus on firms to take all "*sufficient*" steps, rather than all "*reasonable*" steps, to obtain the best possible result for the client.
- In addition to be being able to demonstrate to the client that they have complied with their execution policy, firms will have to be able to demonstrate this to the relevant national competent authority.

C. INVESTMENT FIRM PUBLICATION REQUIREMENTS (RTS 28)

These requirements are designed to increase transparency which is assumed to lead to increased levels of investor protection. The effectiveness of the requirements may depend on whether investors will read the publications and/or spend time analysing that information. A uniform approach to reporting, however, should result in an easier comparison of investment policies.

Aspects of the requirements to note are:

- The obligation to publish information applies to client orders executed on EU and third country execution venues.
- The classes of financial instruments, for which information needs to be published, is wide-ranging and includes: equities, debt instruments, interest rates, credit, currency, equity, securitised and commodities derivatives (listed futures and options and swaps, forwards and other derivatives), CFDs and emission allowances.
- The firm is required to publish data for each of its top five execution venues based upon trading volumes for orders executed for both retail clients and professional clients. This must be presented in separate tables and in a combined table (so that information may need to be published for up to 10 execution venues).
- The firm is also required to publish certain information, including the percentage of client orders executed on the execution venue in question. Such information needs to be broken down into passive (order that provided liquidity), aggressive (order that took liquidity) or directed (by the client) orders.

- The firm is required to publish a summary of its analysis and conclusions drawn from its monitoring of execution quality obtained during the preceding year. In particular, this will require the firm to:
  - explain the relative importance attached to the execution factors;
  - describe close links, conflicts of interest and common ownerships with respect to those execution venues;
  - describe any arrangements in relation to payments received or made, discounts, rebates or other non-monetary benefits received;
  - explain any changes in the list of execution venues listed in the firm's execution policy;
  - explain how order execution differs (if it does) according to client categorisation;
  - explain when other criteria were given precedence over price and cost, when executing retail client orders.

D. EXECUTION VENUE DATA PUBLICATION REQUIREMENTS (RTS 27)

Trading venues, SIs, market makers or other liquidity providers must publish certain information, including:

- The **type** of execution venue, including the name, country of location, and date of the trading day
- The **price** for each trading day on which orders executed:
  - intra-day information, such as the simple average price of all transactions executed in the two minutes starting at each of the following reference times 9:30, 11:30, 13:30 and 15:30; the total value of trades executed; the execution time for each transaction during that two-minute period; and where no transactions occurred during those first two minutes, the price of the first transaction executed within the prescribed price range, trading platform on which the transactions were executed and the best bid and offer or suitable reference price at the time of execution for those transactions;
  - daily information, such as the simple average and volume-weighted average transaction price, along with the highest and lowest executed price (if more than one transaction occurred).
- The **costs** applied by the execution venue, including:
  - component costs, such as execution fees, fees for the submission of orders and fees related to market data access;
  - any rebates or discounts offered to users of the execution venue;
  - any non-monetary benefits;
  - any taxes and/or levies;
  - a link to the website of the execution venue so that more information on costs can be ascertained.
- The **likelihood of execution** for each trading day, including the number of orders or requests for quotes that were received, the number and value of transactions that were executed, and the median transaction size.
- Where the execution venue operates under a **request for quote trading system**, the mean and median amount of time elapsed between the acceptance of a quote and the execution of the order.
- Where an execution venue operated under a **continuous auction order book**, **continuous quote driven trading system** or any **other type of trading system**, for each trading day:
  - best bid and offer price, and corresponding volumes;
  - book depth for three price increments;
  - average volume and spread at best bid and offer;
  - number of cancellations at best bid and offer.

KEY CONTACTS

Tony Katz
Partner
T +44 (0)207 153 7835
tony.katz@dlapiper.com

Puesan Lam
Associate
T +44 (0)207 796 6491
puesan.lam@dlapiper.com