

SWEDISH SECURITIES DEALERS ASSOCIATION

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Guide for drafting/review of Execution Policy under MiFID II

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1. INTRODUCTION

This Guide is drafted by a working group at the Swedish Securities Dealers Association (SSDA) and is intended to assist members in the drafting and/or review of their policy for Execution of Client Orders and for Transmission/Receipt of Client Orders according to the revised Markets in Financial Instruments Directive (MiFID II).¹

¹ [Directive 2014/65/EU](#) of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II).

Under a number of selected topics, the Guide describes the legal requirements in the EU rule-book relating to best execution, including some relevant guidance by ESMA.² It also highlights a number of legal issues which, at the time of publication of this Guide, the working group finds unclear. The Guide does not take into account other rules which may be applicable to the execution of client orders in Sweden, such as civil law requirements under Kommissionslagen (2009:865) or investment firms' agreements with clients.³

This Guide has been adopted by SSDA's Legal Committee. Each version will be dated and made available at SSDA's website: www.fondhandlarna.se.

The information included in this Guide is believed to be accurate at the time of the adoption by the SSDA's Legal Committee but the rules, regulation and interpretation upon which the information is based may be subject to change thereafter. The SSDA makes no representation or warranty for the correctness or completeness of the information set forth herein. This Guide should not be seen as a binding recommendation or legal advice and SSDA members have full discretion to deviate from its content. It is the responsibility of each investment firm to ensure that they comply with the requirements in MiFID II/MiFIR as well as any other rules and regulations which at any point in time is applicable to the execution of client orders and/or transmission and receipt of client orders.

2. WHAT IS BEST EXECUTION?

Best execution is the requirement of investment firms to take "all sufficient steps" to obtain the best possible results for their clients on a continuous basis when either executing transactions on clients behalf or when transmitting orders to other entities for execution.⁴ Firms need to take a range of so-called execution factors into account and determine their relative importance based on the characteristics of their clients, the types of financial instruments for which they receive orders and the markets in which they operate. The factors which firms need to consider when delivering best execution are: price, cost, speed, likelihood of execution and settlement, size or any other consideration relevant to the execution of the order.

Firms shall establish and implement effective arrangements and a policy for complying with the above best execution requirements. This requirement does not mean that firms must obtain the best possible result for clients on every single occasion. Rather, firms need to verify on an ongoing basis that their arrangements and policy work well throughout the various stages of the order execution process.⁵

² The "Questions and Answers" (Q&A) provided by ESMA are available at ESMA's webpage. Each Q & A is dated but may be changed over time.. [https://www.esma.europa.eu/databases-library/esma-library/%22MiFID%20II%22?f\[0\]=im_field_document_type%3A50](https://www.esma.europa.eu/databases-library/esma-library/%22MiFID%20II%22?f[0]=im_field_document_type%3A50).

³ It should be noted that according to SSDA's standard agreement for custody account services, a firm's order execution policy is part of the agreement with the client. See: <http://www.fondhandlarna.se/regler-mm/depakonto-i-vardepappersbolag/allmanna-bestammelser/h/>

⁴ Under MiFID I firms should take "reasonable steps" to obtain best execution. Thus, by requiring firms to take "all sufficient" steps, MiFID II sets a higher bar for firms than its predecessor. ESMA has provided guidance as to how "all sufficient steps" shall be interpreted in its Q & A on Investor Protection, Question 1 dated 10 October 2016.

⁵ ESMA Q & A on Investor Protection, Question 1, dated 10 October 2016, page 13.

The clients shall receive appropriate information on the execution policy. This information shall explain clearly, in sufficient detail and in a way that can be easily understood by clients, how orders will be executed by the investment firm. A summary of the policy shall be provided to retail clients.

The investment firms shall monitor the effectiveness of their order execution arrangements and policy in order to identify and, where appropriate, correct any deficiencies in the arrangements/policy. Firms shall, at request, also be able to demonstrate to clients that they have executed the client's order in accordance with the firm's execution policy, and to competent authorities their compliance with the best execution requirements.

MiFID II introduces two new reporting requirements relating to best execution; to publish a quarterly execution quality report (execution venues) and to at least annually publish top 5 execution venues/brokers (all investment firms).

In addition to the rules of best execution, firms are always subject to the overarching obligation to act honestly, fairly and professionally in accordance with the best interests of its clients.

3. LEGAL FRAMEWORK

The main requirements on best execution are set forth in Article 27 of MiFID II⁶, which has been implemented in Sweden through Chapter 8 paragraphs 31-36 lagen om värdepappersmarknaden.

In addition, the European Commission has adopted detailed rules on level 2. Articles 64 - 66 of the delegated regulation to MiFID II includes provisions regarding e.g. the relative importance of the execution factors, the execution policy and which information should be provided to clients. The requirements regarding the publication of execution quality reports and top five execution venues/brokers are set forth in two regulatory technical standards.⁷ These level 2 rules take the form of regulations and are therefore directly applicable in Member States.

ESMA has also published Questions and Answers (Q & A), which provide further guidance and clarifications as regards the interpretation of the rules on best execution under MiFID II.⁸ The Q & As are directed to both competent authorities and investment firms but do not constitute legally binding documents.

⁶ Under MiFID I, best execution was regulated in Article 21 and Articles 44-46 of the implementing directive (2006/73/EG).

⁷ Commission Delegated Regulation (EU) 2017/575 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards concerning the data to be published by execution venues on the quality of execution of transactions, ("RTS 27") and Commission Delegated Regulation (EU) 2017/576 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution ("RTS 28").

⁸ Q & A documents are used by European Supervisory Authorities to promote common supervisory practices and approaches throughout EU.

As MiFID II is a full-harmonization directive, there is little room to adopt rules under national law regarding best execution which deviate from the EU Rulebook. However, it should be noted that execution of client orders may be subject to requirements in civil law, such as Kommissionslagen (2009:865) as well as agreements with clients.

Annex I includes a non-exhaustive list of applicable rules and regulations.

4. SCOPE OF THE BEST EXECUTION REQUIREMENTS

Investment firms

MiFID II is applicable to investment firms, i.e. firms which have license from the competent authority to provide investment services.

Some entities are exempt from MiFID II, such as management companies regulated under the UCITS or AIFM-directives. A managing company will also be subject to best execution obligations for its fund management activities under UCITS and AIFM directives.⁹

Investment services

Best execution requirements apply to the following investment services (and combinations thereof).

- i) Execution of orders on behalf of clients

When providing the investment service “execution of order on client behalf”, the investment firm acts to conclude agreements to buy or sell financial instruments on behalf of clients. This is for instance the case where a firm is a member of a trading venue and executes the order in its own name on behalf of a client. Another situation is where the investment firm buys or sells units in investment funds on behalf of a client directly from the management company and when the investment firm accepts subscription form from a client to buy shares in a new issue.¹⁰ When providing the service of execution of order, there is normally no intermediary between the investment firm acting on the client’s behalf and the execution venue.

According to MiFID II, the investment service “execution of client orders” has been amended to include “the conclusion of agreements to sell financial instruments issued by an investment firm or a credit institution at the moment of their issuance”.¹¹

Under discussion: It is not clear if and how this amendment to the investment service execution of client orders has an impact on investment firm’s own issues, e.g. bonds, shares or structured products. The preparatory works to the Swedish MiFID II implementation recognizes that there could be practical problems if the investor protection

⁹ Chapter 18-19 FFFS 2013:9. Chapter 3 paragraph 18 FFFS 2013:10 and Articles 27 and 28 Regulation 231/2013/EU.

¹⁰ Prop. 2006/07:115, pages 304-305.

¹¹ Article 4.1(5) MiFID II.

rules were to apply to investment firms own issues but concludes that this issue has to be resolved by the application of law.¹²

ii) Reception and transmission of client orders

When providing the investment service “receipt or transmission of order”, the investment firm receives the client order and passes it on to another firm for execution. This can for instance be the case where the investment firm is not member of the trading venue where the instruments that the client wishes to buy or sell are admitted to trade.

The service “receipt or transmission of client orders” also includes bringing together two or more investors, thereby bringing about a transaction between those investors.¹³ However if that activity also includes that the investment firm concludes agreements to buy or sell financial instruments on behalf of clients, the firm should also be licensed to execute client orders.¹⁴ Under MiFID II, it has been clarified that multilateral trading should take place on trading venues, i.e. regulated markets, MTF or OTF.¹⁵

Please note that, unless stated otherwise, in this Guide the term “execution of orders” and “execution policy” is used to also include the service reception and transmission of orders.

iii) Dealing on Own Account

Dealing on own account means trading against proprietary capital resulting in the conclusion of transaction in financial instruments. According to MiFID, a firm that deals on own account with clients should be considered as executing client orders and therefore be subject to best execution requirements.¹⁶

Best execution rules are applicable when a firm is trading on own account “on behalf of a client”. Under MiFID 1, the European Commission has stated that for request for quote (RFQ) trading when firms act on own account, best execution only applies where the client has legitimate reliance that the investment firm will protect its interest in relation to the execution of the transaction.¹⁷ In order to determine if this is the case, the Commission has presented a four-fold test, also referred to as the “legitimate reliance test”.

“The four fold legitimate reliance test”

According to the Commission, in order to determine whether reliance exists on behalf of the client, firms should take the following four considerations into account:

¹² Prop. 2016/17:162, page 254.

¹³ Recital 44 MiFID II. However, the possibilities for investment firms to provide organized internal client order matching services has become more limited under MiFID II. The general rule is that organized trade shall take place either on a trading venue (regulated market, MTF, OTF) or via a Systemic Internaliser (SI). See Article 1.7 MiFID II and recital 10 MiFIR.

¹⁴ Prop 2006/07:115, page 303.

¹⁵ Article 1.7 MiFID II and recital 9 MiFIR.

¹⁶ Recital 103 Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (“Delegated Regulation MiFID II”).

¹⁷ CESR 07-320, page 22 https://www.esma.europa.eu/sites/default/files/library/2015/11/07_320.pdf .

- whether the firm approaches (initiates the transaction with) the client or the client instigates the transaction by making an approach to the firm. In those cases where the firm approaches a retail client and suggests him to enter into a specific transaction it is more probable that the client will be relying on the firm, to protect his or her interests in relation to the pricing and other elements of the transaction.
 - questions of market practice will help to determine whether it is legitimate for clients to rely on the firm. For example, in the wholesale OTC derivatives and bond markets buyers conventionally 'shop around' by approaching several dealers for a quote, and in these circumstances there is no expectation between the parties that the dealer chosen by the client will owe best execution.
 - the relative levels of transparency within a market will also be relevant. For markets where clients do not have ready access to prices while investment firms do, the conclusion will be much more readily reached that they rely on the firm in relation to the pricing of the transaction.
 - the information provided by the firm about its services and the terms of any agreement between the client and the investment firm will also be relevant, but not determinative of the question. The use of standard term agreements to characterise commercial relationships otherwise than in accordance with economic reality should be avoided.
9. These factors are likely to support the presumption that, in ordinary circumstances, a retail client legitimately relies on the firm to protect his or her interests in relation to the pricing and other parameters of the transaction. Similarly, *prima facie* application of these factors is likely to lead to the presumption that in the wholesale markets clients do not rely on the firm in the same way.

Thus, in order to determine if the firm owes best execution obligations to clients when trading on own account, firms should take the following into account¹⁸:

1. which party initiates the transaction- the client or the firm¹⁹
2. questions of market practice and the existence of a convention to 'shop around';
3. the relative levels of price transparency within a market; and
4. the information provided by the firm and any agreement reached.

Investment firms that rely on this four-folded legitimate reliance test may develop in the execution policy how these criteria are applied for the specific asset class (since that may differ).

Please note that the European Commission also stated in the above extract that in many cases these considerations, taken as a whole, will be met when trading with retail clients, i.e. that such retail clients will normally have a legitimate reliance that they will get best execution.

¹⁸ See also FCA's Thematic Review TR 14/13 <https://www.fca.org.uk/publication/thematic-reviews/tr14-13.pdf>

¹⁹ Recital 85 MiFID II states that "A service should be considered to be provided at the initiative of a client unless the client demands it in response to a personalised communication from or on behalf of the firm to that particular client, which contains an invitation or is intended to influence the client in respect of a specific financial instrument or specific transaction. A service can be considered to be provided at the initiative of the client notwithstanding that the client demands it on the basis of any communication containing a promotion or offer of financial instruments made by any means that by its very nature is general and addressed to the public or a larger group or category of clients or potential clients".

Under discussion: The “legitimate reliance test” is assumed to continue to apply under MiFID II.

Systematic internaliser, market maker and other liquidity provider

According to MiFID II, an investment firm may execute client orders against own account in different capacities such as systematic internalisers, market maker, other liquidity provider.

Under MiFID II (as well as under MiFID I) trading venues, SIs, market makers and other liquidity providers²⁰ are “execution venues”. Investment firms should select and list execution venues in their execution policy (see section 8 below). According to technical standards (RTS 27), execution venues should also publish a quarterly execution quality report.

Under discussion: What is included in “other liquidity provider” is unclear despite some guidance from ESMA in Q & A. Moreover, it is unclear what is the difference between “market maker” and “other liquidity provider”?²¹

iv) Portfolio Management

The investment service “portfolio management” means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments. The orders which result from the portfolio manager’s decision to deal on the client’s behalf can either be placed with another firm for execution or be executed by the firm itself. Such execution activity is considered to be “included” in the license to perform portfolio management services.

Where a portfolio manager places orders with other entities for execution that result from decisions to deal on the clients behalf, the same best execution rules apply as for receipt and transmission of client orders. Where a portfolio manager itself executes the decisions to deal on behalf of a client’s portfolio, the same rules apply as for the service execution of client orders.²²

Financial instruments

Best execution rules are applicable to execution of client orders in financial instruments. An exhaustive list of financial instruments is included in Annex 1 Section C of MiFID II: transferable securities, money-market instruments, units in collective investment undertakings, different types of derivatives and emission allowances.

However, given the differences in market structures or the structure of financial instruments, it may be difficult to identify and apply a uniform standard of and procedure for best execution that would be valid and effective for all classes of instrument. Best execution

²⁰ “Other Liquidity Provider” is defined in recital 7 in RTS 27 as an “investment firm” that holds itself out as being willing to deal on own account with or without formal agreement. Additional guidance is provided by ESMA in ESMA Q & A on investor protection, question 18 dated 25 May 2018.

²² Article 65.8 Delegated Regulation MiFID II and Article 27 MiFID II.

obligations should therefore be applied in a manner that takes into account the different circumstances associated with the execution of orders related to particular types of financial instruments.²³

Class of financial instruments

An execution policy should differentiate between different classes of financial instruments for which a firm carries out orders.²⁴ There is no definition in MiFID II of a “class of financial instrument” but examples of such classes could be equities, debt instruments, units of collective investments and derivatives (which could distinguish between exchange traded derivatives and OTC derivatives). A firm may also elect to use even more differentiated sub-classes where relevant. In particular, there may be good reasons for firms to consider alignment between the classifications used in the policy with the classification used for annual reporting of top 5 execution venues/brokers.²⁵

A firm may choose to include detailed best execution information per each class of instrument in an appendix to the policy. See example in [Annex II](#)

OTC Products

Financial instruments which are not (i) admitted to trade or (ii) traded on a trading venue (i.e. regulated market, MTF or OTF) are referred to as “Over The Counter Products” (OTC).²⁶

MiFID II requires firms which execute orders or taking decisions to deal in OTC products, including bespoke products, to check the *fairness of the price* proposed to the client, by gathering market data used in the estimation of the price of such product and, where possible, by comparing with similar and comparable products.²⁷

The aim of the fairness of price checks is for firms to be able to justify their pricing decisions. Firms need to embed this in their policies and ensure that they have the necessary procedures and arrangements in place as well as appropriate valuation systems.

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

²³ Recital 104 Delegated Regulation MiFID II

²⁴ Article 27.5 first paragraph MiFID II.

²⁵ Annex 1 to RTS 28 list the following classes of financial instruments: **Equities** (Shares and Depositary Receipts), **Debt Instruments** (Bonds and Money Market Instruments), **Interest Rate Derivatives** (Futures and Options admitted to trading on venue and Swaps, Forwards and other Interest Rate Derivatives), **Credit Derivatives** (Futures and Options admitted to trading on venue and other Credit Derivatives), **Currency Derivatives** (Futures and Options admitted to trading on venue and Swaps, Forwards and other Currency Derivatives), **Structured Finance Instruments**, **Equity Derivatives** (Futures and Options admitted to trading on venue and Swaps and other Equity Derivatives), **Securitized Derivatives** (Warrants and Certificate Derivatives and other Securitized Derivatives), **Commodity Derivatives and Emission Allowances Derivatives** (Futures and Options admitted to trading on venue and other Commodity Derivatives and Emission Allowances Derivatives), **Contracts for Difference**, **Exchange Traded Products** (Exchange Traded Funds, Exchange Traded Notes and Exchange Traded Commodities), **Emission Allowances** and **Other [financial] instruments**

²⁶ ESMA Q & A on Investor Protection, Question 2, dated 10 October, footnote 9.

²⁷ Article 64.4 Delegated Regulation MiFID II and ESMA Q & A on Investor Protection, Question 2, dated 10 October 2016.

ESMA has stated that it expects that checks or controls will be calibrated according to the nature of the financial instrument and the characteristics and circumstances of the individual trade.

Please note that OTC Products should be distinguished from OTC-traded products. OTC traded products are instruments which, although they may be admitted to trade or traded on a trading venue, are de facto traded outside a trading venue e.g. via a systematic internaliser executing client orders against own account. An investment firm that intends to execute client orders outside a trading venue must always obtain express consent from the client (see section 9).

Specifically regarding commodities- and FX-related instruments

MiFID II contains requirements that distinguish which commodities and currency contracts are derivatives and which are spot. Spot contracts and FX-contracts used as “means of payment” are not financial instruments and are therefore excluded from MiFID II²⁸, including best execution requirements. However, the overarching obligation to act honestly, fairly and professionally in accordance with the best interests of its clients, always apply.

Under discussion: Article 10.1 b Delegated regulation to MiFID II exempts FX contracts which non-financial counterparties use as “means of payment”. However, it is not entirely clear how the criteria should be understood, in particular (iii) and (iv). The reference to “the contract” does seem to suggest that it is the contract at hand that should be assessed according to the criteria. UK FCA has provided some guidance. ²⁹

Specifically regarding Securities Financing Transactions (SFT)

Securities Financing Transactions are transactions which concern financial instruments, such as repos and securities lending.³⁰ According to MiFID II, the order execution policy established by investment firms should take into account the particular characteristics of SFTs and the firm should separately list the execution venues used for SFTs in its yearly report of top 5 execution venues.³¹

²⁸ 1. For the purposes of Section C(4) of Annex I to Directive 2014/65/EU, other derivative contracts relating to a currency shall not be a financial instrument where the contract is one of the following:

- (a) a spot contract within the meaning of paragraph 2 of this Article,
- (b) a means of payment that:
 - (i) must be settled physically otherwise than by reason of a default or other termination event;
 - ii) is entered into by at least a person which is not a financial counterparty within the meaning of Article 2(8) of Regulation (EU) No 648/2012 of the European Parliament and of the Council (1);
 - (iii) is entered into in order to facilitate payment for identifiable goods, services or direct investment; and
 - (iv) is not traded on a trading venue.

²⁹ <https://www.fca.org.uk/publication/consultation/cp16-29.pdf>, page 315

³⁰ According to Article 3(11) Securities Financing Regulation (EU) 2015/2365, securities financing transactions (SFT) means: (a) a repurchase transaction; b) securities or commodities lending and securities or commodities borrowing; (c) a buy-sell back transaction or sell-buy back transaction; (d) a margin lending transaction. Regarding application of MiFID I to SFT, see Commission’s Replies in Your Questions on MiFID, questions 28.1 and 128.

³¹ According to recital 99 of Delegated Regulation to MiFID II, when applying the criteria for best execution for professional clients, firms will typically not use the same execution venues for SFTs and other transactions. This is because the SFTs are used as a source of funding subject to a commitment that the borrower will return equivalent securities on a future date and the terms of SFTs are typically defined bilaterally between the counterparties ahead of the execution. Therefore, the choice of execution venues for SFTs is more limited than

ESMA has clarified in Q & A that SFT contracts are not covered by the reporting obligations in RTS 27.³²

Categories of Clients

According to MiFID II, best execution applies to retail clients and professional clients, although there are some differences in the legal requirements e.g. as regards the relative importance of execution factors (see section 5). In its policy, an investment firm should address the distinction between retail and professional clients to the extent that the firm treats those categories differently.

Under MiFID II, retail clients shall be provided with a summary of the policy (see section 10).

As a general rule, transactions with eligible counterparties are exempt from best execution requirements under MiFID, unless they request treatment as a professional client.³³ Such request can be general or in respect of a certain transaction. According to ESMA, this general exemption does however not cover the requirements for execution venues to publish quarterly execution quality reports according to Article 27.3 MiFID II and RTS 27. For such reports, the client category is not relevant and, hence, all transactions need to be included. However, the obligation to publish yearly information on top 5 trading venues/brokers under Article 27(6) of MiFID II and RTS 28 only cover orders relating to retail and professional clients, but not eligible counterparties.³⁴

Under MiFID II/MiFIR, all clients which are legal entities must obtain a LEI in order to trade. In fact, technical standards prohibit investment firms from offering services where a client LEI would be required before obtaining the LEI from that client.³⁵

Investment firms will also need to provide the trading venue with additional data in relation to orders. This includes information on Client Identification (e.g. LEI or National ID.) See Appendix II.

5. EXECUTION FACTORS AND RELATIVE IMPORTANCE

Execution factors

The policy should include a description of the execution factors and their relative importance or the principles that the firm applies to determine their relative importance. It should be explained to the client how these factors are considered as part of “all sufficient steps” to obtain the best possible result for the client.

in the case of other transactions, given that it depends on the particular terms defined in advance between the counterparties and on whether there is a specific demand on those execution venues for the financial instruments involved.

³² ESMA Q & A on Investor Protection, Question 15, dated 10 July.

³³ Article 30 MiFID II.

³⁴ ESMA Q & A on Investor Protection, Question 12, dated 4 April 2017.

³⁵ Article 26.6 MiFIR states “in reporting the designation to identify the clients as required under paragraphs 3 and 4, investment firms shall use a legal entity identifier established to identify clients that are legal persons”.

The execution factors, which are unchanged under MiFID II, are:

- (i) price
- (ii) cost
- (iii) speed of execution
- (iv) likelihood of execution and settlement
- (v) size of the order
- (vi) any other consideration relevant to the execution of the order

“Any other considerations” may include factors such as likely market impact.

It should also be noted that the meaning of “price” and “cost” may vary between different asset classes. When trading equities, clients pay a transaction fee in the form of commission whereas for bonds and derivatives the transaction fee is often included in the spread.

Retail clients - total consideration

Where an investment firm executes an order on behalf of a retail client, MiFID II states that the best possible result shall be determined in terms of the total consideration, i.e. the price of the financial instrument and the costs relating to execution. Those costs shall include expenses incurred which are directly related to the execution of the order (such as execution venue fees and clearing and settlement and any other fees paid to third parties involved in the execution of the order).³⁶ In practice many firms only include those execution costs which are passed on to the client.

Speed, likelihood of execution and settlement, the size and nature of the order, market impact and any other implicit transaction costs may be given precedence over the immediate price and cost consideration only insofar as they are instrumental in delivering the best possible result in terms of the total consideration to the retail client.³⁷

Professional clients – relative importance of execution factors

For professional clients, the investment firm shall determine the relative importance of the execution factors. According to MiFID II, firms should take the following into account:

- i) the characteristics of the client (retail/professional)
- ii) the characteristics of the client order, including where the order involves a securities financing transaction (SFT);
- iii) the characteristics of financial instruments that are the subject of that order;
- iv) the characteristics of the execution venues to which that order can be directed.

Illustrative example:

[Name of investment firm] will, using its reasonable judgement, weigh the execution factors at the time of execution in accordance with the client’s characteristics, the type or order, financial instrument involved and prevailing market conditions.

³⁶ In COM’s Your Questions on MiFID, question 114.1, the Commission states that the ‘costs related to execution’ include all expenses incurred by the client which are directly related to the execution of the order. In practice many firms only include those execution costs which are passed on to the client.

³⁷ Recital 101 Delegated Regulation MiFID II.

Unless, Special Circumstances set forth in this policy apply, [name of investment firm]’s priority when executing an order for a professional client will be to obtain the best possible result for the client in terms of the [Total Consideration] [followed by xx and yy]”.

Depending on the type of market and firm’s execution methods, there may be a reason to provide a more granular description of the relative importance of the execution factors per asset class, sub-class or instrument type. See example in [Annex II](#).

Special circumstances

There may also be circumstances where an investment firm may want to deviate from how it generally prioritize between the execution factors. This could for instance be the case for large orders or orders in illiquid instruments where other factors such as certainty of execution and market impact is deemed more important or in cases where market conditions such as severe market disruptions does not enable the firm to follow the general rule set forth in its policy.

Where applicable, also examples of such special circumstances could be described in the policy.

6. SPECIFIC CLIENT INSTRUCTIONS

An investment firm satisfies its obligation under MiFID II to take all sufficient steps to obtain the best possible result for a client if it executes in accordance with specific instructions from the client.

Examples of such client instructions could be: selection of a specific execution venue or the use of a specific algorithm or execution of an order over a particular timeframe.

However, when an investment firm executes an order following specific instructions from the client, it should be treated as having satisfied its best execution obligations only in respect of the part or aspect of the order to which the client instruction relate. The fact that the client has given specific instructions which cover one part or aspect of the order should not be treated as releasing the investment firm from its best execution obligations in respect of any other parts or aspects of the client order that are not covered by such instructions. Thus, for such other parts of the transaction the firm may need to consider execution factors and their relative importance in accordance with the execution policy.³⁸

According to MiFID II, the information to a client on best execution should include a clear and prominent warning that any specific instructions from a client may prevent the firm from taking the steps that it has designed and implemented in its execution policy to obtain the best possible result for the execution of those orders in respect of the elements covered by those instructions.³⁹

³⁸ Recital 102 Delegated Regulation MiFID II.

³⁹ Article 66.3 f Delegated Regulation MiFID II.

Illustrative example:

*“Where a client provides [name of investment firm] with a specific instruction on how all or part of its order should be executed, the relevant execution will be effected in accordance with such order. The specific instruction from a client, will have precedence over what is stated in this policy. **Warning: a specific instruction from the client may therefore signify that [name of investment firm] will not follow the procedures set forth in this policy to obtain the best possible result for the execution of client’s order.***

If the client has only given a specific instruction which applies only to one part or one aspect of an order, [name of the firm] may still owe best execution obligations in the part of the order that is not covered by the specific instruction of the client”.

MiFID II prohibits investment firms from inducing clients to instruct it to execute an order in a particular way, by expressly indicating or implicitly suggesting the content of the instruction to the client, when the firm ought reasonably to know that an instruction to that effect is likely to prevent it from obtaining the best possible result for that client. However, this does not prevent a firm inviting a client to choose between two or more specified trading venues, provided that those venues are consistent with the execution policy of the firm.⁴⁰

A firm may refuse to follow an instruction by a client e.g. if it after the firm’s judgement would contravene the rulebook of the execution venue or relevant legislation such as market abuse regulation.⁴¹

7. DIFFERENT METHODS FOR EXECUTING CLIENT ORDERS

Investment firms shall provide information to clients, in sufficient detail and in a way that can be easily understood by clients, *how* orders will be executed by the investment firm.⁴²

In order to obtain best execution for clients, an investment firm may use one or a combination of different methods of execution and also act in different trading capacities. In practice, this will depend on e.g. type of market and financial instrument, see Annex III.

Some investment firms, in particular with more complex business, may choose to describe some general scenarios in the policy which can then be further developed in an Appendix per asset class, sub-class or type of instrument, see Annex II.

Execution on a trading venue or Over-the-Counter (OTC)

i) Execution on trading venue

Investment firms may execute orders directly on a trading venue, i.e. regulated market, MTF or OTF. If an investment firm is not a member, it may trade indirectly through a third party investment firm (e.g. broker) which is a member of such venue (see section 7).

⁴⁰ Recital 102 Delegated Regulation MiFID II.

⁴¹ Prop. 20066/07:115, page 452.

⁴² Article 27.5 second paragraph MiFID II.

A transaction is deemed to be executed on a trading venue if it is carried out through the systems or under the rules of that trading venue. Thus, a transaction need not be executed in an order book to be considered as “on venue” trade. Also transactions which are negotiated off-book but reported to the venue in accordance with its rules are covered. Such manual trades must however benefit from a waiver from pre-trade transparency requirements e.g. negotiated trade waiver or large in scale waiver⁴³ (See below regarding double volume cap).

ii) Execution outside trading venue (OTC trading)

Investment firms may also execute orders outside trading venues e.g. against own account or by crossing client’s orders. According to MiFID, trading outside a trading venue (OTC trade) requires express consent from the client (see section 9). As a general rule, this includes when firms execute client order against own account e.g. as Systematic Internaliser.⁴⁴ However, there is no requirement to obtain a consent apply for OTC-instruments which are neither admitted to trade nor traded on a trading venue.⁴⁵

A new requirement under MiFID II is that where an investment firm executes client orders outside a trading venue, the client shall also receive information of the consequences of this means of execution, for example counterparty risk.⁴⁶

It should also be noted that for some request for quote (RFQ), application of the so-called four fold legitimate reliance test may imply that no best execution obligations are owed to the client (See section 4).

iii) Trading obligation under MiFID II

It should be noted that MiFID II introduces a so-called trading obligation for certain types of instruments. For instance, as a rule, shares shall be traded on regulated markets, MTF or with an SI. OTC trade in shares is only possible where the trades either:⁴⁷

- (a) are non-systematic, ad-hoc, irregular and infrequent; or
- (b) are carried out between eligible and/or professional counterparties and do not contribute to the price discovery process.

Furthermore, MiFIR sets out a trading obligation for certain derivatives which are subject to the clearing obligation under EMIR and deemed sufficiently liquid under MiFID II. If caught by the trading obligation, the derivative may only be traded on regulated market, MTF or OTF (not through systematic internaliser).⁴⁸

⁴³ Recital 7 MiFIR and ESMA Q & A on Transparency, Section 6 Question 3 c) dated 31 January 2017. In NASDAQ’s rulebook these trades are referred to as “manual trades”.

⁴⁴ Article 27.5 third paragraph MiFID II

⁴⁵ CESR Q & A on Best Execution, page 10 paragraph 21.2

⁴⁶ Article 66.3e Delegated Regulation MiFID II.

⁴⁷ Article 23.1 MiFIR.

⁴⁸ Article 28 MiFIR.

According to ESMA RTS on trading obligation, instruments within the following categories are covered (depending on duration):⁴⁹

Fixed-to-float IRS: EUR, GBP and USD

Index CDS – iTraxx Europe Main and iTraxx Europe Crossover.

iv) Double Volume Cap

For Equities, MiFID II introduces a new concept “double volume cap” which will have an impact on trading done under the pre-trade transparency waivers called “reference price waiver” and “negotiated trade waiver”. The negotiated trade waiver is commonly used when firms negotiate transactions outside the venue but report it to the venue in accordance with its rule book (sometimes referred to as “manual trades”).

For any trading in shares done under these two waivers on venues within the EU there are two volume caps that will apply, limiting the total amount of trading that can be done in any particular equity instrument under these waivers.

The two caps are set at 4% per venue trading and at 8% on overall trading across the EU. The caps are calculated based on the on-book traded volumes of the reference market for each given security over a 12-month rolling period.

If a cap is breached a suspension in trading of the given instrument under these waivers will be triggered. This can be on a particular venue (in the event of a breach of the 4% cap) or across the EU (in the case of a breach of the 8% cap). It will still be possible to execute transactions under other waivers, such as large in scale (LIS). Where a suspension is triggered, the investment firm will no longer be able to execute the client orders using these waivers.

It should be noted that trading venues may have different policies and arrangements to stop orders before hitting the 4% thresholds. Investment firms may also want to regulate their own use of the waivers in their execution policy.

Trading capacity

When executing client orders, an investment firm may act in different capacities. Often a distinction is made between when a firm acts agent or principal. As a general rule, best execution obligation applies in both of these capacities, with the exception of the “legitimate reliance test” (see section 4).

i) Agency Trading

When a firm acts in an agency capacity it trades in its own name on the client’s behalf. This is commonly the case when firms execute clients’ orders on a trading venue. In Sweden, this activity is normally subject to the requirements of Kommissionslagen (2009: 865).

⁴⁹ COMMISSION DELEGATED REGULATION (EU) 2017/2417 of 17 November 2017 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on the trading obligation for certain derivatives

ii) Principal Trading

Investment firms may also trade in a principal capacity and execute client orders against its own books, including as a systematic internaliser or market maker/other liquidity provider. For the purpose of the list of execution venues in the policy and the annual reporting of top 5 execution venues, it is then the investment firm itself (acting in capacity of SI, market maker, other liquidity provider) that should be reported as venue.

Trading as principal/own account generally exposes the investment firm to market risk. However, in some cases, the firm may act as riskless principal. Riskless principal is a trade in a financial instrument that involves two orders, with the execution of one of these orders dependent upon the receipt or execution of the other, e.g. if an investment firm who has received a client order immediately executes an identical order in the market, while taking on the role of principal, in order to fill the client order. In some markets, to qualify as riskless principal trades, the trades should be executed at the same price, exclusive of markup/markdown, commission or other fees.

According to MiFID II, as a general rule, firms owe best execution obligations when it executes orders against own account on a client's behalf and should apply the same execution factors as when executing on other venues.⁵⁰ However, one important exemption is on request for quote (RFQ) markets where "the four-folded legitimate reliance test" apply (see section 4).

Investment firms which act as principal in RFQ trading and relies on the legitimate reliance test, should describe this test and the assessment in its execution policy. In this connection, the policy could also include some illustrative examples of when the investment firm typically will consider that a client put legitimate reliance on the firm to protect its interests (or vice versa).

Execution through third parties (brokers or affiliates)

An investment firm may use other investment firms to execute client orders, i.e. transmit the client's order to a third party for execution. This is for instance often the case when the investment firm is not member of the trading venue where the financial instruments are traded.

When executing client orders by transmitting to third parties, investment firms shall ensure that the third party will provide best execution on a continuous basis, i.e. by applying the execution factors set out in MiFID II. The investment firm should therefore collect and review the execution policy of the third party firm.

In order to get best execution, the investment firm may be classified as a professional client or retail client. Investment firms which are eligible counterparties may also request to get best execution (i.e. while remaining classified as eligible counterparty when applying other parts of MiFID II).⁵¹

⁵⁰ Recital 103 Delegated Regulation MiFID II.

⁵¹ Article 30 MiFIR.

Direct Electronic Access (DEA)

“Direct electronic access” (DEA)⁵² means an arrangement where a member or participant or client of a trading venue permits a person to use its trading code so the person can electronically transmit orders relating to a financial instrument directly to the trading venue.

Direct Electronic Access can be divided into:

- DMA (Direct Market Access): the order is sent using the members infrastructure or
- SA (Sponsored Access): the order is sent without using the member infrastructure, i.e. the person is connected directly to the trading system.

The member or participant is, for both DMA and SA, subject to requirements to have organization, systems and controls in place in order to promote fair and orderly trading.

NB: Orders sent through a “online brokerage” system or through a Smart Order Router are *exempt* from being classified as DEA, since the person cannot exercise discretion regarding the exact fraction of a second of order entry.⁵³

Smart Order Router (SOR)

A “Smart Order Router” (SOR) is an algorithm used for optimization of order placement on different trading venues, in order to fulfil best execution. The SOR may split the original order into smaller parts in order to execute according to the execution policy.⁵⁴

The concepts of Orders, Request for Quotes, AIOs, Packaged Orders, etc.

i) Order

As noted in section 4, an investment firm owes best execution obligations when executing orders on behalf of a client or when receiving and transmitting such orders to other entities for execution. Generally speaking, although there is no specific definition in MiFID II/MiFIR, an “order” could be defined as *a binding instruction from a client to an investment firm to purchase or sell a financial instrument*.

Depending on the arrangements of an investment firm in relation to various types of financial instruments, an investment firm may specify different order types available. The investment firm may also include information on their arrangement for algorithmic trading which is used in the execution of client orders.

ii) Request For Quote (RFQ)

Best execution may apply where an investment firm engages in trading on own account proprietary trading by quoting on a “request for quote” basis, where the client has legitimate reliance that the investment firm will protect the client’s interests in relation to the execution of the transaction (see section 4 “the four fold legitimate reliance test”). This is normally the case when providing quotes to retail clients. Moreover, article 6 of RTS 27

⁵² See recital 18 and Article 37 in MiFID II, article 20 Delegated Regulation MiFID II and Article 4(1)(41) MiFID II.

⁵³ See Prop. 2016/17:162, page 325-326 and Article 20.1 and 20.2 Delegated Regulation and Consultation Paper, MiFID II/MiFIR, 22 May 2014, ESMA/2014/549, page 236.

⁵⁴ Consultation Paper, MiFID II/MiFIR, 19 December 2014, ESMA/2014/15699, page 341.

requires execution venues to provide information not only on orders but also on requests for quotes (RFQs), without providing a definition to the latter term.

Generally speaking, a RFQ is *an invitation to provide an executable offer to buy or sell a specific financial instrument*. In order to be a RFQ sufficient information must be provided to allow the recipient, if it so chooses, to provide an executable quote in response. The European Commission has in MiFID I given the example that a RFQ is at hand when client A requests a quote from investment firm B for 100 shares of X. The firm provides a quote which the client accepts and asks to buy 100 shares at the price quoted by B.⁵⁵

The investment firm can also offer so called streaming quotes. In that case the client will receive a stream of quotes, for a limited period, instead of a single quote. This is common for instrument types where the price of the instrument is updated frequently, and a single quote is likely to be invalid shortly after the request.

In Annex 1, Table 1 to RTS 2 a “Request-for-quote trading system” is defined as follows: “A trading system where a quote or quotes are provided in response to a request for a quote submitted by one or more other members or participants. The quote is executable exclusively by the requesting member or market participant. The requesting member or participant may conclude a transaction by accepting the quote or quotes provided to it on request.”

iii) Actionable indication of interests (AIOI)

In MiFID II, an actionable indication of interests (AIOI) is defined as *a message from one member or participant to another within a trading system in relation to available trading interest that contains all the necessary information to agree on a trade*.⁵⁶ Further ESMA consider an actionable IOI as a binding expression to trade from one counterparty to another in a specific financial instrument which should contain information such as the price, volume, and the side or direction (i.e. whether it is a buy or a sell order).⁵⁷

iv) Packaged order

According to MiFIR, a “package order” means an order priced as a single unit in two or more financial instrument for the purpose of executing a package transaction.⁵⁸ A package transaction means:

- a) An exchange for physical⁵⁹; or
- b) A transaction involving the execution of two or more component transactions in financial instruments and which fulfils all of the following criteria:
 1. the transaction is executed between two or more counterparties;
 2. each component of the transaction bears meaningful economic or financial risk related to all the other components; and
 3. the execution of each component is simultaneous and contingent upon the execution of all the other components.

⁵⁵ CESR Q & A 07/320.

⁵⁶ Article 2(1)(33) MiFIR.

⁵⁷ Consultation Paper MIFIR dated 19 December 2014.

⁵⁸ Article 2.1 (49) MiFIR.

⁵⁹ According to article 2.1 (48) MiFIR, “Exchange for physical” means contract or other financial instrument contingent on the simultaneous execution of an equivalent quantity of an underlying physical asset.

Thus, a package order relates to a group of trades that is executed as one single transaction. According to ESMA, a package order/transaction have to exclusively be composed by non-equity instruments and not e.g. shares.⁶⁰ The package can consist of the same type of financial instruments (e.g. interest rate derivatives such as swaps) or different types of financial instruments (e.g. a bond and interest rate swaps). As a response to a request for quote from the client, the investment firm will provide a quote for the whole package.

8. SELECTION OF EXECUTION VENUES/BROKERS

Execution Venues

In accordance with MiFID II, the investment firm may use one of the following main categories of “execution venues” when executing client orders in financial instruments.

EXECUTION VENUES	
Trading venues	OTC (executing client orders own account)
Regulated market ⁶¹	Systematic Internaliser (SI) ⁶⁴
Multilateral Trading Facility (MTF) ⁶²	Market Maker ⁶⁵
Organized Trading Facility (OTF) ⁶³	Other Liquidity Provider ⁶⁶

Specifically re. Organized Trading Facility (OTF)

The OTF is a new type of trading venue that has been introduced in MiFID II.

According to MiFID II, an ‘organized trading facility’ or ‘OTF’ means a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract;

It should be noted that “system” does not mean an automated order book but could also be a set of rules according to which the firm executes trades.⁶⁷ On level 3, ESMA has provided more guidance as to the interpretation of system. ⁶⁸ An investment firms that qualify as OTFs must apply for authorization with competent authorities.

⁶⁰ ESMA Q & A on Transparency, Section 4, Question 4 b dated 3 October 2017.
⁶¹ Article 4(1)(21) MiFID II.
⁶² Article 4(1)(22) MiFID II.
⁶³ Article 4(1)(23) MiFID II.
⁶⁴ Article 4(1)(20) MiFID II.
⁶⁵ Article 4(1)(7) MiFID II.
⁶⁶ There is no definition of “Other Liquidity Provider” in MiFID II. However, some guidance is found in recital 7 to RTS 27. See footnote 20 above.
⁶⁷ See recital 7 in MiFIR and ESMA Q & A on Market Structure, Section 5.2 Question 3 dated 3 April 2017. ESMA states that “A system would be easily identified when embedded in an automated system. This would cover a situation where, for instance, the arrangements in place consist of the automated crossing of client trading interests, subject to the exercise of discretion on an OTF. However, other non-automated systems or repeatable arrangements that achieve a similar outcome as a computerised system, including for instance where a firm would reach out to other clients to find a potential match when receiving an initial buying or selling interest, would also be characterised as a system. Where a firm would, by coincidence and accidentally, receive matching buying and selling interests, and decide to execute those orders internally, such unpredictable circumstances would not qualify as the operation of a system.
⁶⁸ ESMA Q & A on Market Structure, Question 3 dated 3 April 2017.

The main differences between an OTF and MTF/regulated market are.⁶⁹

a) OTFs may only trade in bonds, structured finance products, derivatives and emission allowance (non-equity instruments) whereas regulated markets and MTFs may trade in all asset classes;

b) There are less stringent limitations to the type of activities that the operator of the OTF may undertake both in relation to matched principal trading and trading on own account.⁷⁰

c) As opposed to regulated markets and MTFs which are governed by non-discretionary rules, the OTF operator must exercise discretion either when deciding to place or retract an order on the OTF and/or when deciding not to match potential matching orders available in the system;

d) As opposed to regulated markets and MTFs that have members or participants, OTFs have clients. As a consequence, transactions concluded on OTFs have to comply with client facing rules, including best execution rules.

Specifically regarding systematic internaliser (SI)

Under MiFID I investment firms could become SIs for shares. Under MiFID II there is also a possibility to become SIs for equity-like instruments (e.g. ETF) and non-equity instruments (e.g. bonds and derivatives).

A systematic internaliser (SI) is a firm which “on an organized, frequent and substantial basis” deals on own account when executing client orders outside a trading venue.⁷¹ In level 2 there are quantitative thresholds which determine if these criteria are fulfilled. Firms may also opt-in as SI. Firms shall notify competent authorities when they become an SI.

It follows from MiFID II that the price quoted by an SI shall reflect prevailing market conditions.⁷² Moreover, according to level 2, if an investment firm provides a quote to a client upon request and that quote would meet the investment firm's obligations under MiFID II if the firm executed that quote at the time the quote was provided, then the firm should meet those same obligations if it executes its quote after the client accepts it, provided that, taking into account the changing market conditions and the time elapsed between the offer and acceptance of the quote, the quote is not manifestly out of date.⁷³

Specifically regarding market makers and other liquidity providers⁷⁴

⁶⁹ ESMA Q & A on Market Structure, Questions 4-6 dated 3 April 2017.

⁷⁰ Additional restrictions apply as an OTF and a SI cannot be operated by the same legal entity.

⁷¹ Article 4.1 (20) MiFID II.

⁷² Article 14 and 18 MiFIR

⁷³ Recital 103 Delegated Regulation MiFID II.

⁷⁴ It should be noted that an investment firm may also act “market maker” on a trading venue, i.e. where the firm has agreed to provide liquidity by quoting two way prices. For such transactions, it is the trading venue that will be the execution venue and not the market maker/liquidity provider.

Investment firms that trade on own account on behalf of clients without being an SI may fall under the definition of “market maker” or “other liquidity provider”. The difference between these two categories is not entirely clear.

According MiFID II, *market maker* “means a person who holds himself out on the financial markets on a continuous basis as being willing to deal on own account by buying and selling financial instruments against that person’s proprietary capital at prices defined by that person”.⁷⁵

Other liquidity provider it not a defined term in MiFID II. However, in a recital to a level 2 technical standard, it is stated that *liquidity providers* “should include firms that hold themselves out as being willing to deal on own account, and which provide liquidity as part of their normal business activity, whether or not they have formal agreements in place or commit to provide liquidity on a continuous basis.”⁷⁶

List of execution venues

The policy shall include a list of execution venues (i.e. regulated market, MTF, OTF, SI, market maker and other liquidity provider) to which the firm has direct access as well as factors used for the selection.⁷⁷ The list shall be per class of instrument.

Where the investment firm executes orders by trading on own account on behalf of a client acting as an execution venue, i.e. as SI, market maker or other liquidity provider, it is the investment firm that should be included in the list.

According to MiFID II, clients shall receive a list of execution venues which shall be provided in a durable medium (or by means of a web-site when certain conditions are fulfilled).⁷⁸

Selection of execution venues

Firms should select execution venues which enables it to provide best execution to clients on a continuous basis, taking the execution factors into account. In this connection, firms may also consider qualitative factors like clearing schemes, circuit breakers, scheduled auctions, or any other relevant considerations⁷⁹. As a basis for its selection, firms should analyze the quarterly execution quality reports published in accordance with RTS 27 to evaluate and compare execution venues.

With respect to investment firms that execute orders on behalf of clients, MiFID draws a distinction between the selection of venues to be included in the firm's execution policy and the choice between two or more venues contained in the execution policy for the execution of a particular transaction.

⁷⁵ Article 4.1 (7) MiFID II.

⁷⁶ Recital 7 RTS 27.

⁷⁷ Article 66 Delegated Regulation MiFID II.

⁷⁸ Article 3.2 Delegated Regulation MiFID II.

⁷⁹ Article 66.3 (c) Delegated Regulation MiFID II.

In its Q & A on Best Execution under MiFID I,⁸⁰ CESR stated that firms, when selecting venues to be included in its execution policy, should not take into account the fees and commissions that it will charge its clients. At this stage, the firm should focus on the potential of the venues to enable the firm to obtain on a consistent basis the best possible result for the execution of its client orders. In other words, it should focus on the quality of execution available on the various venues. However, when choosing a venue for the execution of a particular client order (from among the venues included in the firm's execution policy that are capable of executing such an order), the firm should take into account the effect of its own fees and commissions on the total consideration to the client.

For example, if a firm has included a regulated market and a systematic internaliser in its execution policy (or is itself a systematic internaliser) because both those venues enable the firm to obtain on a consistent basis the best possible result for the execution of its client orders, the firm will need to take into account not only the prices displayed by those two venues, but also any difference in fees or commission it charges the client for executing on one venue rather than the other (as well as any other costs or other relevant factors).

Third party brokers/affiliates

Firms performing the investment services of portfolio management and of transmission and receipt of orders, shall provide clients information on the entities to which the investment firm transmits orders for execution, such as third party brokers. Also the selection criteria and their relative importance should be included.

Firms should have policy and arrangements for the selection of third party brokers. This should be based on objective criteria e.g. access to trading venue, market coverage.

MiFID clarifies that its best execution provisions are not intended to require a firm that transmits or places orders with other entities for execution to duplicate the efforts of its execution entities. Rather, a firm should determine that the entities it uses will enable it to comply with the overarching best execution requirement when placing an order with, or transmitting an order to, another entity for execution.

To this end, a firm should review the execution arrangements and policy of the third party it wishes to use to determine whether they will allow the firm to comply with all its best execution requirements.

In its Q & A on Best Execution under MiFID I⁸¹, CESR stated that when determining whether an entity is likely to enable the firm to obtain the best possible result for its clients, a firm also may need to consider:

1. whether the entity itself is subject to Article 27 MiFIR for the relevant business, that is, whether the entity is an investment firm executing or receiving and transmitting orders on behalf of the firm and the entity has agreed to treat the firm as a retail or professional client⁸²;

⁸⁰ CESR Q & A 07/320, Question 12, page 9.

⁸¹ CESR Q & A 07/320, Question 22, page 12.

⁸² Investment firms which are eligible counterparties may also request to get best execution i.e. while remaining classified as eligible counterparty when applying other parts of MiFID II.

2. whether the entity will undertake by contract to comply with any or all of the MiFID best execution requirements in relation to the relevant business (with the result that it has contractual but not regulatory responsibilities for best execution); and
3. whether the entity can demonstrate that it delivers a high level of execution quality for the kind of orders that the investment firm is likely to place with or transmit to it.

Firms are not restricted to using entities subject to MIFID for carrying out their orders. In order to be able to use an entity that is not subject to the MiFID best execution regime, in particular a non-EEA service provider, firms should ensure that the execution arrangements of such an entity allow them to comply with the overarching best execution requirement.⁸³

Investment firms shall ensure that the third party will provide best execution on a continuous basis when executing the investment firm's order, i.e. by applying the execution factors set out in MiFID II. The investment firm should therefore collect and review the execution policy of the third party.

If a portfolio manager executes transactions itself, the above-mentioned rules for execution of client orders apply.

In addition to the above requirements relating to Best Execution, where the third party is an affiliate company, the firm should also ensure that it handles any conflicts of interest. The firm may disclose in the execution policy that execution can take place through affiliate companies.

Single venue/broker

MiFID II does not prevent firms from only having one selected venue/broker in its policy. However, firms must be able to show that this allows them to obtain best execution for their clients on a consistent basis. Investment firms should select a single execution venue only where they can reasonably expect that the selected execution venue will enable them to obtain results for clients that are at least as good as the results that they reasonably could expect from using alternative execution venues. This reasonable expectation must be supported by relevant data published in accordance with Article 27 of MiFID II or by other internal analyses conducted by the firms.⁸⁴

For units in investment funds, it is the management company to which the orders are directed for subscription or redemption of orders which normally is the single execution venue. However, if the units are traded on a venue, firms should consider if trading on venue could offer clients better terms than when dealing directly with the management company.⁸⁵

⁸³ According to CESR Q & A, where the firm cannot satisfy itself that this is the case, it should not use such non-EEA entities.

⁸⁴ Recital 108 Delegated Regulation MiFID II.

⁸⁵ See COM's "Your Questions on MiFID", Question 120.3, 55 and 56.

9. INFORMATION TO CLIENTS AND CONSENT

Information to clients

An investment firm shall provide appropriate information about its (execution) policy to its clients.⁸⁶ More specifically, MiFID II requests that such information shall explain clearly, in sufficient detail and in a way that can be easily understood by clients, how orders will be executed for the client. The Delegated Regulation to MiFID II specifies that such information shall be customised depending on the class of financial instruments and type of the service provided, and includes a stipulated and extended list of details (as compared to under MiFID I) that shall be provided to clients “in good time” prior to the provision of the service.⁸⁷ Where a client makes reasonable and proportionate requests for information about its policies and arrangements and how they are reviewed, the investment firm shall answer clearly and within a reasonable time.

Format of the information

The information on execution policy shall be provided to the clients in a durable medium or by means of a website (where that does not constitute a durable medium) provided that certain conditions are satisfied.⁸⁸

A durable medium shall enable the client to store the information and allows unchanged reproduction of the information stored. Some examples of durable medium is paper, e-mails and pdf-files.⁸⁹

Where information is provided in a durable medium, also notifications regarding changes should be provided in a durable medium (see section 11).

It should be noted that according to SSDA’s standard agreement for custody account services, a firm’s order execution policy is part of the agreement with the client.⁹⁰

Client consent

Similar to MiFID I, MiFID II requires investment firms to obtain a) the prior consent of their clients to the order execution policy, and b), where the policy provides for the possibility that client orders may be executed outside a trading venue, the prior express consent of their clients before proceeding to execute their orders outside a trading venue.⁹¹ The latter

⁸⁶ Article 27(5) MiFID II.

⁸⁷ Article 66(2) and (3) Delegated Regulation MiFID II and CESR Q & A 07/320, e.g. Question 15, page 10.

⁸⁸ Article 66(3), second paragraph and Article 3(2), both Delegated Regulation MiFID II.

⁸⁹ Recital 24 to directive 2007/64 on payment services mentions the following as another durable medium: “printouts by account printers, floppy disks, CD-ROMs, DVDs and hard drives of personal computers on which electronic mail can be stored, and Internet sites, as long as such sites are accessible for future reference for a period of time adequate for the purposes of information and allow the unchanged reproduction of the information stored. However, it should be possible for the payment service provider and the payment service user to agree in the framework contract on the manner in which subsequent information on executed payment transactions is given, for instance, that in Internet banking all information on the payment account is made available online”.

⁹⁰ Article 46 Delegated Regulation MiFID II.

⁹¹ Article 27(5) MiFID II.

consent may be obtained either in the form of a general agreement or in respect of individual transactions.

Further, similar to MiFID I, MiFID II provides no specific guidance on the difference between “consent” and “express consent”. However, in a Supervisory Briefing from 2008, CESR provides the following guidance⁹²:

- prior consent to their execution policy: This can be tacit. A client can indicate consent by seeking to trade with a firm after having received appropriate information on the execution policy in good time before the provision of the service;
- prior express consent before executing orders outside a regulated market or multilateral trading facility: This requires the client to actively demonstrate consent by signature, e-mail, web-page click, telephone call, etc. Express consent is not required where the relevant financial instrument is not admitted to trading on a regulated market or multilateral trading facility.

A new requirement under MiFID II is that where an investment firm executes client orders outside a trading venue, the client shall also receive information of the consequences of this means of execution, for example counterparty risk.⁹³

10. GUIDE FOR SUMMARY TO RETAIL CLIENTS

Investment firms are required to provide retail clients with a summary of the execution policy, focused on the total costs they incur. The summary shall also provide a link to the most recent execution quality data published in accordance with Article 27(3) of Directive 2014/65/EC for each execution venue listed by the investment firm in its execution policy.⁹⁴

ESMA has not provided any guidance as to the content of the summary. However, taking into account that the aim is to provide retail clients with easy to understand information on best execution and the costs they potentially face when submitting an order, it is recommended that the summary is not too long and in an easy to understand language.

11. MONITORING AND REVIEW OF POLICY

Monitoring

When designing their execution policies and establishing their execution arrangements, firms will have to ensure that the intended outcomes can be successfully achieved on an on-going basis.

This will require firms to monitor not only the execution quality obtained but also the quality and appropriateness of their execution arrangements and policies on an ex-ante and ex-post

⁹² https://www.esma.europa.eu/sites/default/files/library/2015/11/08_735.pdf. A similar statement is found in CESR Q & A 07/320 question 21, pages 11-12.

⁹³ Article 66(3e) Delegated Regulation MiFID II.

⁹⁴ Article 66(9) Delegated Regulation MiFID II.

basis to identify circumstances under which changes may be appropriate (as an example, continuous monitoring of firms' processes might involve some combination of front office and compliance monitoring and could use systems that rely on random sampling or exception reporting). Investment firms should have channels in place to ensure that the results of ongoing execution monitoring are escalated to senior management and/or relevant committees and fed back into execution policies and arrangements to drive improvements in the firm's processes. Investment firms shall also be able to demonstrate to their clients, at client's request, that the firm has executed their orders in accordance with the execution policy. However, the monitoring and validation requirement should not be interpreted to mean that a firm must obtain the best possible results for its clients on every single occasion. Rather, firms will need to verify on an on-going basis that their execution arrangements work well throughout the different stages of the order execution process.

An investment firm shall each year publish for each class of instrument, a summary of the analysis and conclusions they draw from their detailed monitoring of the quality of execution obtained on the execution venues where they executed all client orders in the previous year.

Review and information of material changes

Investment firms shall review, at least on an annual basis, their execution policy as well as their order execution arrangements.

Investment firms shall notify clients with whom they have an ongoing client relationship of any material changes to their order execution arrangements or execution policy.

A material change shall be a significant event that could impact parameters of best execution such as cost, price, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.

The addition or removal of execution venues or brokers is generally not considered a material change unless it is one of the main venues/brokers that the investment firm relies on for execution for a certain class of financial instrument. Non-material changes will only be published on [*link to website*].

LIST OF RULES AND REGULATION

A list of applicable rules and regulations which are applicable to best execution requirements, including preparatory works and guidance. The list is non-exhaustive.

Swedish legislation

Lag (2007:528) om värdepappersmarknaden

http://www.riksdagen.se/sv/dokument-lagar/dokument/svensk-forfattningssamling/lag-2007528-om-vardepappersmarknaden_sfs-2007-528

Kommissionslagen (2009: 865)

http://www.riksdagen.se/sv/dokument-lagar/dokument/svensk-forfattningssamling/kommissionslag-2009865_sfs-2009-865

Lag (2004:46) om värdepappersfonder

http://www.riksdagen.se/sv/dokument-lagar/dokument/svensk-forfattningssamling/lag-200446-om-vardepappersfonder_sfs-2004-46

Lag (2013:561) om förvaltare av alternativa investeringsfonder

http://www.riksdagen.se/sv/dokument-lagar/dokument/svensk-forfattningssamling/lag-2013561-om-forvaltare-av-alternativa_sfs-2013-561

Finansinspektionens föreskrifter om värdepappersrörelse, FFFS 2017:2

<http://www.fi.se/sv/vara-register/sok-fffs/2017/20172/>

Preparatory works

Nya regler om marknader för finansiella instrument, proposition 2016/17:162

<http://www.regeringen.se/496172/contentassets/6e03c321ca034eb2b77fba180fbc6fb6/nya-regler-om-marknader-for-finansiella-instrument-mifid-ii-och-mifir-del-1-av-2-prop.-201617162>

Nya regler om marknader för finansiella instrument, lagrådsremiss

<http://www.regeringen.se/48f3fd/contentassets/96124c8c82b64d10a526a34f26284243/nya-regler-om-marknader-for-finansiella-instrument-mifid-ii-och-mifir>

Några Finansmarknadsfrågor, Promemoria

<http://www.regeringen.se/49ef7c/globalassets/regeringen/dokument/finansdepartementet/rattsdokument/promemorior/nagra-finansmarknadsfragor.pdf>

Värdepappersmarknaden MiFID 2 och MiFIR, SOU 2015:2

<http://www.regeringen.se/49bb2f/contentassets/41dd7f9e65a64c3ea312af020dc57931/vardepappersmarknaden-mifid-ii-och-mifirdel-1-sou-20152>

Finansinspektionens Memorandum to FFFS 2017:2

<http://www.fi.se/globalassets/media/dokument/fffs-bilagor/2017/beslutspm-fffs-2017-2-10.pdf>

MiFID II legislative texts

Level 1

[Directive 2014/65/EU](#) of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU

Amendment: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32016L1034>

[Regulation \(EU\) No 600/2014](#) of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012

Amendments: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32016R1033>

Level 2

Delegated acts and implementing acts (published in Official Journal):

<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ%3AL%3A2017%3A087%3ATOC>

Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (“Delegated Regulation MiFID II”)

http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2017.087.01.0001.01.ENG&toc=OJ:L:2017:087:TOC

Level 3

ESMA Q & A on Investor Protection (updated regularly)

[https://www.esma.europa.eu/databases-library/esma-library/%22MiFID%20II%22?f\[0\]=im_field_document_type%3A50](https://www.esma.europa.eu/databases-library/esma-library/%22MiFID%20II%22?f[0]=im_field_document_type%3A50)

Other relevant EU legislation

Regulation (EU) 2015/2365 of the European Parliament and Council of 25 November 2015 on transparency of securities financing transactions and of reuse.

<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R2365&from=EN>

Other guidance

CESR Q & A on best execution, CESR 07-320

https://www.esma.europa.eu/sites/default/files/library/2015/11/07_320.pdf

FCA Thematic Review TR 14/13

<https://www.fca.org.uk/publications/thematic-reviews/tr14-13-best-execution-and-payment-order-flow>

Specifically regarding Legal Entity Identifier (LEI)

MiFID II will require investment firms that execute transactions in financial instruments on behalf of a client which is a legal entity, to include that client firm's LEI within the transaction report sent to the competent authority.

A Legal Entity Identifier (LEI) is a 20-character alphanumeric code (based on ISO 17442) assigned to uniquely identify a legal entity that is counterparty to a financial transaction.

Therefore, all clients which are legal entities must obtain a LEI in order to trade. In fact, technical standards prohibit investment firms from offering some investment services before obtaining the LEI from that client.⁹⁵

Clients obtain a LEI directly via any of the LEI providers or, in some cases, via the investment firm

More information on LEI can e.g. be found at <https://www.gleif.org/en/lei-focus/how-to-get-an-lei> or via Finansinspektionen's webpage, www.fi.se

Specifically regarding obligation to send client Identification information to trading venues

MiFID II will introduce new reporting obligations for trading venues for orders in financial instruments which are handled through their systems⁹⁶. As a result, investment firms will need to provide the trading venue with additional data in relation to such orders. This includes information on client Identification (e.g. LEI or National ID.)

Trading venues may use different technical solutions to collect this information. Firms could contact the relevant trading venue to get more information.

APPENDIX: [class of instrument]

1. Products in scope

This appendix to the [name of investment firm] execution policy provides further details regarding the application of best execution requirements in relation to [class or sub-class of instrument].

This includes [different types of instruments that belong to the class or sub-class of instrument. (For instance, if the class is Debt Instruments, the firm may want to make a distinction between the two sub-classes bonds and money market instrument but also different types of bonds such as sovereign bonds and corporate bonds)].

2. How the firm applies best execution

[Description of when and for whom you have best execution obligations in this class of instrument. If relevant, text should include your interpretation of the four fold rules in relation to the specific instruments and customer categories]

3. Prioritisation of Execution Factors

When executing client orders to which best execution applies [name of investment firm] shall take the following Execution Factors into account:

- i) Price
- ii) Costs
- iii) Speed
- iv) Likelihood of execution and settlement
- v) Size, and
- vi) Nature or any other consideration relevant to the order

[Firms may want to explain each term in relation to the asset class]

For professional clients [class of instrument], [name of investment firm] will prioritize as follows: [insert priority of the execution factors above]. For retail clients, the firm will focus on the “total consideration”, see section [xx] in the execution policy. [Describe if “total consideration” in any way alters the prioritization of execution factors compared to professional clients]

4. The order/quote handling process

[Description of execution of how client orders are placed (such as manually or electronically) and in which capacity they are serviced (such as agent or principal)]

[Description of the different order types ((such as DMA, Algo order, Internalisation/RFQ) applicable to the class of instrument]

We execute an order by one of the following methods or combination of methods:
[Description of your order handling processes related to the instrument and order type]

5. Execution venues/brokers

Example 1:

When [name of company] trades as Principal, the execution venue will usually be [name of investment firm].

Below is a list of other Execution Venues that [name of investment firm] uses when executing client orders in [class of instrument].

Name of venue

[Name of investment firm] may also in some situation use affiliated or non-affiliated third country firms and brokers to execute client orders in [class of instrument].

Name of broker

Example 2:

When [name of company] trades as Principal, the execution venue will usually be [name of investment firm].

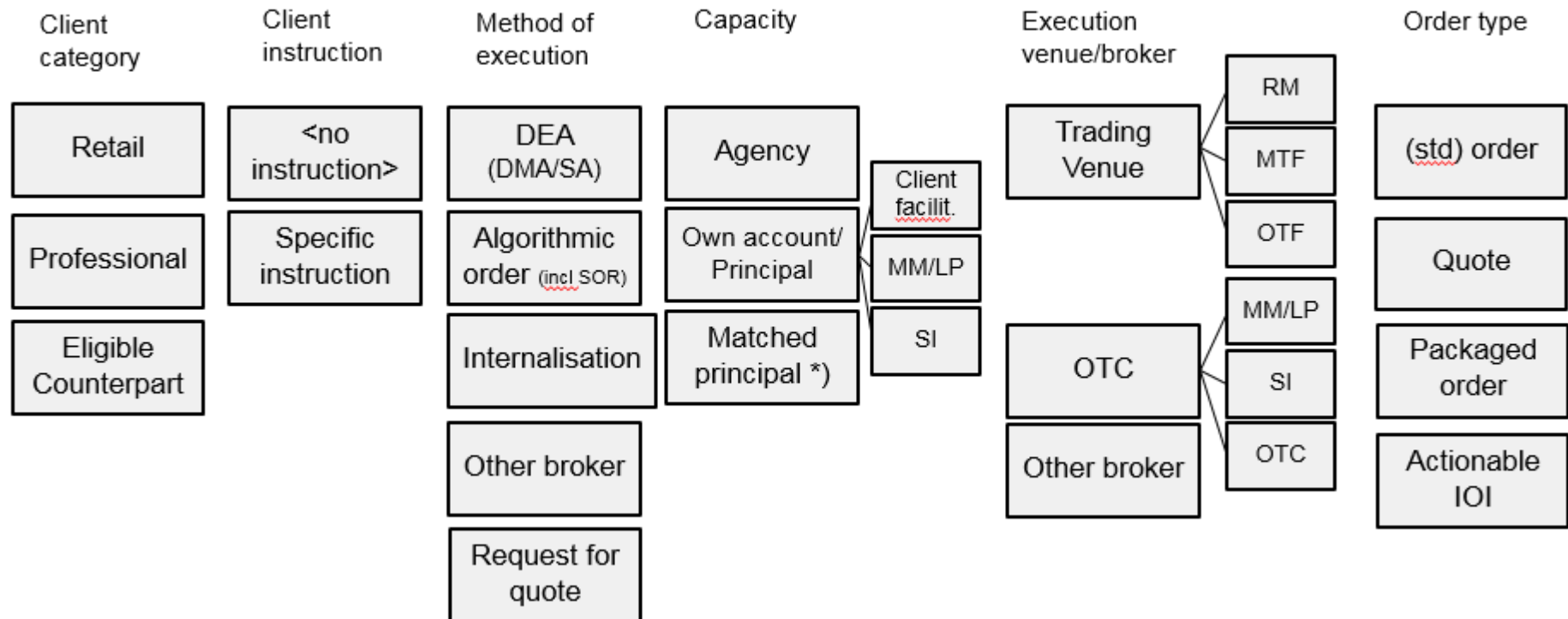
We will use execution venues to execute client orders in [class of instrument]. In some situations, we may also use affiliated or non-affiliated third country firms and brokers to execute client orders in [class of instrument]. A list of the relevant execution venues and brokers related to execution in [class of instrument] are found on [add relevant email address where clients can access your list of venues and brokers]. We will update this list when necessary. You will not be notified separately of any changes to these venues. You should therefore refer to the current list of Execution Venues from time to time.

6. Benchmarking and monitoring

Wherever possible, best execution price streams are benchmarked against external and internal reference prices to ensure that best execution is achieved on a consistent basis. For [class of instrument] we use the following: [description].

ILLUSTRATION OF DIFFERENT METHODS OF EXECUTION

ANNEX IV



GLOSSARY

ANNEX V

Link to European Commission's Glossary of useful terms linked to markets in financial instruments: https://ec.europa.eu/info/system/files/glossary_en.pdf