Best Execution
Helping financial firms effectively manage their MiFID II obligations

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In this Accenture point of view on Markets in Financial Instruments Directive II (MiFID II) we explore some of the challenges surrounding the new Best Execution requirements. This is the latest in a series of thought pieces published by Accenture on the topic of MiFID II.

Previous documents include:


Before reviewing the requirements in more detail, it is worth highlighting that Best Execution requirements are not new and were originally introduced under MiFID I in 2007. As part of the original legislation, designated clients were offered the assurance that all reasonable steps would be taken to execute orders so as to deliver the best possible results for certain products and under certain conditions.

These requirements have remained largely unchanged since then, although it is worth highlighting that within the UK, the Financial Conduct Authority (FCA) launched a thematic review in 2014 to provide an industry assessment of Best Execution implementation across the industry. A summary of these findings follows.

Key recommendations made as part of the 2014 FCA thematic review include:¹

- **Total Consideration:** Distinction made between explicit external costs and explicit internal costs. Based on this, firms can omit their own fees and charges from a best execution assessment when selecting a venue.
- **Monitoring:** Monitoring to include all relevant asset classes, the execution factors and the monitoring methodology to be captured. In addition, aspects such as venue or third-party broker selection and the use of price benchmarks and tolerances for exception reporting to be made clear.
- **Reliance:** Emphasizing that best execution is owed when the client places legitimate reliance on the firm, a fourfold test should therefore be applied for professional clients. Specifically: (i) which party initiated the transaction; (ii) confirm market practice and the existence of a convention to “shop around;” (iii) identify the relative levels of price transparency within a market; and (iv) review information provided by the firm and any agreement reached.

Although the review outlined examples of good practice currently employed by some firms, it is probably fair to say that, overall, the industry initially struggled to implement Best Execution in line with the FCA’s guidelines. This has led some organizations to embark on a number of quite complex remediation programs, often extending beyond a year in duration.

It is against this backdrop that the updated MiFID II Best Execution requirements were introduced to take effect as of January 2018. A summary of these requirements, contrasted against the MiFID I requirements is shown in Figure 1 below.

Looking at the figure above there are a number of areas where the MiFID II requirements build upon and strengthen the MiFID I requirements. A good example of this is the first point highlighted in Figure 1 and which states that firms must now take all sufficient steps to obtain, when executing orders, the best possible results for their clients, rather than all reasonable steps.

Another change from MiFID I is the requirement for execution venues (such as RMs, MTFs, organized trading facilities (OTFs), systematic internalizers, market makers and other liquidity providers) to publish quarterly a non-trivial amount of data.

This data references orders, quotes, executed trades and its related costs at the instrument level for each trading day so as to reflect the quality of the execution through derived information such as speed and likelihood of execution.

Lastly, MiFID II Best Execution requirements also call for investment firms to annually publish reports providing information on client orders relating to firms’ top 5 execution venues by trading volumes.
Details behind these reports were left rather vague under Level 1; however, more clarity was provided in the draft Regulatory Technical Standards (RTS) published in September 2015. A summary of the requirements under Articles 27 and 28 of the RTS is illustrated in Table 1 below.

**Table 1. MiFID II Regulatory Technical Standards – A Summary of Key Requirements**

<table>
<thead>
<tr>
<th>RTS</th>
<th>Article</th>
<th>Article Theme</th>
<th>Requirements Overview</th>
</tr>
</thead>
<tbody>
<tr>
<td>27</td>
<td>1-2</td>
<td>Scope of Regulation and Definitions</td>
<td>Outlines the scope of requirements for RTS 27 and defines key terms (“trading system” and “size specific to the financial instrument”).</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>General Information</td>
<td>Execution venues are required to provide general information, including name and venue identifier, the name of the market segment, a summary of any outages or auctions experienced on the trading day and the number of failed transactions on the trading day.</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Price</td>
<td>Execution venues are required to provide key price information, including intra-day information, primarily for transactions occurring within specified two-minute reference times.</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Costs</td>
<td>Execution venues are required to provide an overview of the direct and indirect costs applied by the execution venue to client transactions, including executions fees, fees related to market data access and use of terminals, clearing and settlement fees, any rebates, discounts and non-monetary benefits, taxes and levies.</td>
</tr>
<tr>
<td></td>
<td>6</td>
<td>Likelihood of Execution</td>
<td>Execution venues are required to provide an overview of the likelihood of client transactions being executed, based on order, quote and requests for quote (RFQ) measures such as the number of cancelled and modified orders, the number of orders or requests for quotes received and the number and value of transactions executed.</td>
</tr>
<tr>
<td></td>
<td>7</td>
<td>Additional Information for Continuous Auction Order Book and Continuous Quote-Driven Execution Venues</td>
<td>Execution venues are required to provide additional information when operating under a continuous auction order book, continuous quote-driven trading system or any other type of trading system for which information is available. These include average book depth, average effective spread and the number of different types of order failures, such as Fill or Kill.</td>
</tr>
<tr>
<td></td>
<td>8</td>
<td>Additional Information to be Published for Request for Quote Execution Venues</td>
<td>Execution venues are required to provide additional information related to the speed of execution when operating under a request for quote trading system or any other type of trading system for which information is available.</td>
</tr>
<tr>
<td></td>
<td>9-12</td>
<td>Determination of Reporting Ranges, Format for Publication, Periodicity of Publication and Entry into Force</td>
<td>Outlines additional information that primarily informs when, how and how often publication is required.</td>
</tr>
<tr>
<td>28</td>
<td>1</td>
<td>Scope of Regulation</td>
<td>Outlines the scope of requirements for RTS 28. Note that these apply to investment firms, and not just execution venues, as per RTS 27.</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Information on the Top Five Execution Venues and Quality of Execution Obtained</td>
<td>Investment firms are required to publish information on executed orders for each of the firm’s top five execution venues, including the name of the venue, the class of financial instruments and volume and number of client orders executed on the venue, as a percentage of total executed orders. Details should be split into three core reports, one for retail clients, one for professional clients (both excluding Securities Financing Transactions) and one for Securities Financing Transactions orders only regardless of the type of client. Investment firms also need to produce a piece of analysis to justify their choice of execution venues when executing client orders over the past year.</td>
</tr>
<tr>
<td></td>
<td>3-4</td>
<td>Format and Entry into Force</td>
<td>Outlines additional information that primarily informs how and when publication is required.</td>
</tr>
</tbody>
</table>

Based on the MiFID II requirements, we have identified three key use cases to consider when reviewing Best Execution. These are illustrated in Figure 2 below.

**Figure 2. Best Execution Use Case Examples**

**Best Execution Analytics**

**Use Case 1: Regulatory Reporting**
- Pre-defined set of 12 standardized reports to be generated on a quarterly (RTS 27), or annual (RTS 28) basis by execution venues and investment firms.
- Requires significant transactional, venue, reference, market and pre-trade data sourcing.
- Format of publication has not been defined; however, it will need to be made available for consumption by the general public as well as regulators free of charge.

**Use Case 2: Ad-Hoc Client Reporting**
- Clients may request additional information related to an execution on an ad-hoc basis.
- The executing organization will need to provide this information in a timely manner in line with the original client request.
- Note that MiFID II does not significantly expand this requirement over and above MiFID I.

**Use Case 3: Monitoring**
- Execution venues to continually review the quality of their executions and comply with the firm’s execution policy.
- Metrics to be produced on a regular basis to demonstrate compliance.
- Requires in our view significant intra-day market data access to implement.
- Note that MiFID II does not significantly expand this requirement over and above MiFID I.

Source: Accenture, April 2016
The implementation of these use cases will likely present a number of challenges to the implementing party. A summary view of these is discussed in the following sections.

In the case of most regulatory reporting requirements the end-user is usually the regulator. Even if the report is sent via a third party (such as a trade repository), the information is only made available to the regulator and cannot be accessed by any other parties. Under the MiFID II Best Execution reporting requirements, however, this information needs to be made available to the general public and may be subject to download and analysis.

Given the nature of the information involved (execution and order data) we may expect that some firms would be conscious of the impact of this information being made public. Indeed, it may transpire that some third parties may try to take some commercial advantage of the additional information now available from across the industry. Publishing firms should consider this when reviewing their Best Execution reporting solution under RTS articles 27 and 28.

Firms subject to Best Execution requirements may also be tempted to modify their business model to help reduce the impact of those requirements. As an execution venue, the product scope is largely narrowed when acting as a market maker or liquidity provider as opposed to a Systematic Internalizer. Firms might therefore decide to reduce the volume of their business for some instruments where they believe they can be exposed to additional requirements for publication.
Control models

As we highlighted in “MiFIR Transaction Reporting: Preparing for the Challenges ahead,” the industry is currently putting a lot of focus on the control and quality assurance processes associated with regulatory reporting.

In particular, organizations should take steps when publishing data externally and for regulatory purposes that it be accurate, complete and consistent with regulatory requirements.

In order to respond to this, many organizations are focusing on the quality and control models, to support a higher degree of confidence in the reporting produced, and to allow potential issues to be flagged internally and remediated before identification by the regulator or other external parties.

Regulatory rule clarity

Although the draft technical standards from September 2015 outlined the tables and content to include in the reporting, there are a number of areas around field interpretation that require further clarity from the regulator.

This is particularly true for information related to costs. Some requirement fields have also been written with an equity model in mind, which makes interpretation very challenging when considering reporting on fixed income, currencies and commodities (FICC) products. Legal and compliance departments should play an important role in helping firms engage with the regulators and in assisting with the interpretation.

Our previous experience with other regulatory work has demonstrated the importance of a strong industry approach to conducting peer reviews of key aspects of new requirements and properly discussing common approaches to managing a program. Accenture is one of the industry participants active in organizing working groups in this area and we anticipate that these and other forums will play an important function in the process as the industry positions itself within the Best Execution discussion.
Data

The data requirements for Best Execution reporting are extensive and call for a significant amount of information to be sourced from within the organization. The quarterly and annual Best Execution reports require over 100 fields to be captured, which is greater than the number of fields called for under the MiFID II Transaction Reporting requirements.

In addition to the sheer quantity, it is worth highlighting the diversity of the field requirements which include the following categories:

- Market data
- Reference data
- Transaction data
- Pre-trade data
- Venue data
- Trading events data

Within this list it is worth highlighting that a number of data points may not previously have been required for regulatory or any other type of reporting, and so many firms may not have this data at hand. Indeed, Accenture’s work in this area suggests that firms may need to source up to 50 percent of the data points for the first time. This suggests that organizations may find themselves spending a significant amount of time performing a non-trivial data sourcing and remediation exercise.

In addition to this, firms should also consider data completeness and accuracy. Given that reporting is due at an instrument rather than a macro level, some firms may find that they have information available for some products and asset classes but not for others. Organizations should also consider how accurate their data is and review control points around data management, cleaning and approval.

Technology

In considering technology solutions to the Best Execution reporting challenge, one of the key points to scrutinize is the volume of data that will need to be collated and the number of reports that will need to be generated. Some larger firms may find that they will have up to 1 million transactions a day in scope for the Best Execution requirements.

Given the quarterly reporting requirements for each single financial instrument traded—for each trading day it is traded—this may mean that firms will need to consider the associated data requirements for up to 65 million transactions and the publication of thousands (if not millions) of reports each quarter.

Firms should therefore consider how to manage the associated data requirements and have adequate capacity within their solution. As part of this, firms may wish to explore the benefits of cloud-based and other solutions in order to help reduce data storage costs and allow for more rapid capacity increases if required.

When considering the comparable data requirements across the three main Best Execution use cases, affected firms may wish to use a similar toolset to perform their regulatory reporting, ad-hoc client reporting and monitoring activities. This would warrant a platform flexible enough to consider all of these different requirements. As well, firms may also wish to expand their capabilities by adding analytical skills to capture greater insight from the data available. These analytical insights may be used for trader monitoring and surveillance, among other use cases.
Operating model

Since Best Execution reporting is a new obligation, in many cases there will not be an existing operating model to leverage when implementing.

Some firms may consider other regulatory implementations as a guide and implement a similar ownership model for activities such as Trade and Transaction Reporting. Other firms may consider a Best Execution provision as a front-office-owned activity and hence may look to allocate ownership to this group, while others may consider a hybrid model.

While the ownership model will be dependent on the individual organizational model of the firm in question, all firms should implement a robust operating model with an appropriate governance model to actively track and manage the firm’s Best Execution obligations.

Policies

Investment firms subject to Best Execution requirements will also have to reflect those regulatory changes in their policies.

MiFID II Level 1 clearly requires investment firms to make available to their clients their order execution policy, with clear details of the cases where the investment firms will owe best execution, and the potential impacts on the execution of client orders.

Those policy changes may have a broader impact on the investment firm’s business, as it might choose to reduce or remove some of its trading activities as a result.
How Accenture can help

Accenture has experience in assisting financial services firms with their Best Execution obligations for both MiFID I and MiFID II. As this document indicates, the Best Execution requirements are extensive and call for significant capabilities in a number of areas including requirements definition, data collection, data accuracy and completeness, operating and governance model definition, and technology platforming.

Within this last area Accenture has leveraged a number of pre-existing capabilities in order to produce a platform to help clients comply with the three key Best Execution uses cases (regulatory reporting, ad-hoc client reporting and monitoring). A high-level functional Accenture architecture is illustrated in Figure 3.

This Accenture framework includes market data storage, data ingestion, analytics and reporting capabilities. This simplified solution leverages the capabilities and experience of Accenture and the Accenture Enkitec Group (a leading Oracle implementer), and the Accenture Insights Platform (AIP) which has been successfully implemented at over 40 client organizations worldwide.

By utilizing an integrated framework (Figure 3), firms would be able to consider their full Best Execution capabilities in one integrated package. The analytics layer would also allow firms to generate additional insight for use in trader surveillance and other monitoring activities.
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Figure 3 Accenture Integrated Best Execution Framework

Source: Accenture, April 2016
The MiFID II Best Execution requirements represent a non-trivial obligation for affected firms and extends an already complex set of requirements from MiFID I. Organizations are expected to have a broad set of challenges to address when reviewing their implementation strategy, and it is important to consider an integrated approach. The impact of the FCA thematic review is still being addressed within the industry, and some firms may have the double challenge of responding to both. Firms should consider the full end-to-end impact across the operating model of their solution suite and the impact on their clients and regulatory commitments.
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