11.2 Best execution for AIFMs and residual CIS operators

Application

This section applies to:

1. a small authorised UK AIFM and a residual CIS operator in accordance with COBS 18.5.2R; and

2. a full-scope UK AIFM and an incoming EEA AIFM branch, in accordance with COBS 18.5A.3R.

In accordance with COBS 18.5.4R, this section does not apply to a small authorised UK AIFM of an unauthorised AIF or a residual CIS operator of a fund whose fund documents include a statement that best execution does not apply in relation to the fund and in which:

1. no investor is a retail client; or

2. no current investor in the fund was a retail client when it invested in the fund.

In accordance with COBS 18.5A.8R, only the following provisions of this section apply to a full-scope UK AIFM and an incoming EEA AIFM branch:

- COBS 11.2.5G;
- COBS 11.2.17G;
- COBS 11.2.23AR;
- COBS 11.2.24R;
- COBS 11.2.25R(1) and COBS 11.2.26R, but only where an AIF itself has a governing body which can provide prior consent; and
- COBS 11.2.27R, but only regarding the obligation on an AIFM to notify the AIF of any material changes to its order execution arrangements or execution policy.

A firm to which this section applies may comply with its obligations under this section by complying with the rules in COBS 11.2B (Best execution for UCITS management companies).
COBS 11 : Dealing and managing

Section 11.2 : Best execution for AIFMs and residual CIS operators

11.2.3 In accordance with COBS 18.5.3R(1) and COBS 18.5A.5R, references in this section to customer or client are to any fund for which the firm is acting or intends to act.

11.2.2 In accordance with COBS 18.5.1AR and COBS 18.5.3R(2), in the case of a small authorised UK AIFM of an unauthorised AIF which is a collective investment scheme, or a residual CIS operator, when a firm is required by the rules in this section to provide information to, or obtain consent from, a fund, the firm must ensure that the information is provided to, or consent obtained from, an investor or a potential investor in the fund as the case may be.

11.2.1 In accordance with COBS 18.5.3R(3) and COBS 18.5A.9R, references to the service of portfolio management in this section are to be read as references to the management by a firm of financial instruments held for or within the fund.

Obligation to execute orders on terms most favourable to the client

11.2.1 A firm must take all reasonable steps to obtain, when executing orders, the best possible result for its clients taking into account the execution factors.

[Note: The Committee of European Securities Regulators (CESR) has issued a Question and Answer paper on best execution under the first Markets in Financial Instruments Directive (MiFID I, 2004/39/EU). This paper also incorporates the European Commission’s response to CESR’s questions regarding the scope of the best execution obligations under MiFID I. The paper can be found at: https://www.esma.europa.eu/sites/default/files/library/2015/11/07_320.pdf]

11.2.1A [deleted]

Application of best execution obligation

11.2.2 The obligation to take all reasonable steps to obtain the best possible result for its clients (see COBS 11.2.1R) should apply to a firm which owes contractual or agency obligations to the client.

11.2.3 [deleted]

11.2.4 If a firm provides a quote to a client and that quote would meet the firm’s obligations to take all reasonable steps to obtain the best possible result for its clients if the firm executed that quote at the time the quote was provided, the firm will 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.
The obligation to deliver the best possible result when executing client orders applies in relation to all types of financial instruments. 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 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. For example, transactions involving a customised OTC financial instrument that involve a unique contractual relationship tailored to the circumstances of the client and the firm may not be comparable for best execution purposes with transactions involving shares traded on centralised execution venues.

Best execution criteria

When executing a client order, a firm must take into account the following criteria for determining the relative importance of the execution factors:

1. the characteristics of the client including the categorisation of the client as retail or professional;
2. the characteristics of the client order;
3. the characteristics of financial instruments that are the subject of that order; and
4. the characteristics of the execution venues to which that order can be directed.
5. [deleted] instrument constituting the fund.

Role of price

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

For the purposes of ensuring that a firm obtains the best possible result for the client when executing a retail client order in the absence of specific client instructions, the firm should take into consideration all factors that will allow it to deliver the best possible result in terms of the total consideration, representing the price of the financial instrument and the costs related to execution. 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.
A firm’s execution policy should determine the relative importance of each of the execution factors or establish a process by which the firm will determine the relative importance of the execution factors. The relative importance that the firm gives to those execution factors must be designed to obtain the best possible result for the execution of its client orders. Ordinarily, the FCA would expect that price will merit a high relative importance in obtaining the best possible result for professional clients. However, in some circumstances for some clients, orders, financial instruments or markets, the policy may appropriately determine that other execution factors are more important than price in obtaining the best possible execution result.

Delivering best execution where there are competing execution venues

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

The obligation to deliver best execution for a retail client where there are competing execution venues is not intended to require a firm to compare the results that would be achieved for its client on the basis of its own execution policy and its own commissions and fees, with results that might be achieved for the same client by any other firm on the basis of a different execution policy or a different structure of commissions or fees. Nor is it intended to require a firm to compare the differences in its own commissions which are attributable to differences in the nature of the services that the firm provides to clients.

A firm must not structure or charge its commissions in such a way as to discriminate unfairly between execution venues.

A firm would be considered to structure or charge its commissions in a way which discriminates unfairly between execution venues if it charges a different commission or spread to clients for execution on different execution venues and that difference does not reflect actual differences in the cost to the firm of executing on those venues.

Requirement for order execution arrangements including an order execution policy

A firm must establish and implement effective arrangements for complying with the obligation to take all reasonable steps to obtain the best possible result for its clients. In particular, the firm must establish and implement an order execution policy to allow it to obtain, for its client orders, the best possible result in accordance with that obligation.
The order execution policy must include, in respect of each class of financial instruments, information on the different execution venues where the firm executes its client orders and the factors affecting the choice of execution venue. It must at least include those execution venues that enable the firm to obtain on a consistent basis the best possible result for the execution of client orders.

(1) When establishing its execution policy, a firm should determine the relative importance of the execution factors, or at least establish the process by which it determines the relative importance of these factors, so that it can deliver the best possible result to its clients.

(2) In order to give effect to that policy, a firm should select the execution venues that enable it to obtain on a consistent basis the best possible result for the execution of client orders.

(3) A firm should apply its execution policy to each client order that it executes with a view to obtaining the best possible result for the client in accordance with that policy.

(4) The obligation to take all reasonable steps to obtain the best possible result for the client should not be treated as requiring a firm to include in its execution policy all available execution venues.

The provisions of this section which provide that costs of execution include a firm's own commissions or fees charged to the client for the provision of an investment service should not apply for the purpose of determining what execution venues must be included in the firm's execution policy.

The provisions of this section as to execution policy are without prejudice to the general obligation of a firm to monitor the effectiveness of its order execution arrangements and policy and assess the execution venues in its execution policy on a regular basis.

### Following specific instructions from a client

(1) Whenever there is a specific instruction from the client, the firm must execute the order following the specific instruction.

(2) A firm satisfies its obligation under this section to take all reasonable steps to obtain the best possible result for a client to the extent that it executes an order, or a specific aspect of an order, following specific instructions from the client relating to the order or the specific aspect of the order.

When a 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 instructions 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 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.
A firm should not induce a client 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 should 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.

Information about the order execution policy

A firm must provide appropriate information to its clients on its order execution policy.

(1) A firm must provide a retail client with the following details on its execution policy in good time prior to the provision of the service:

(a) an account of the relative importance the firm assigns, in accordance with the execution criteria, to the execution factors, or the process by which the firm determines the relative importance of those factors;

(b) a list of the execution venues on which the firm places significant reliance in meeting its obligation to take all reasonable steps to obtain on a consistent basis the best possible result for the execution of client orders;

(c) 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.

(2) This information must be provided in a durable medium, or by means of a website (where that does not constitute a durable medium) provided that the website conditions are satisfied.

A full-scope UK AIFM and an incoming EEA AIFM branch must make available appropriate information on its execution policy required under article 27(3) of the AIFMD level 2 regulation (Execution of decisions to deal on behalf of the managed AIF) and on any material changes to that policy to the investors in of each AIF it manages.

Where the order execution policy provides for the possibility that client orders may be executed outside a regulated market or an MTF, the firm must, in particular, inform its clients about this possibility.

Client consent to execution policy and execution of orders outside a regulated market or MTF

(1) A firm must obtain the prior consent of its clients to the execution policy.
A firm must obtain the prior express consent of its clients before proceeding to execute their orders outside a regulated market or an MTF. The firm may obtain this consent either in the form of a general agreement or in respect of individual transactions.

Monitoring the effectiveness of execution arrangements and policy

A firm must monitor the effectiveness of its order execution arrangements and execution policy in order to identify and, where appropriate, correct any deficiencies. In particular, it must assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best possible result for the client or whether it needs to make changes to its execution arrangements. The firm must notify clients of any material changes to their order execution arrangements or execution policy.

Review of the order execution policy

(1) A firm must review annually its execution policy, as well as its order execution arrangements.

(2) This review must also be carried out whenever a material change occurs that affects the firm’s ability to continue to obtain the best possible result for the execution of its client orders on a consistent basis using the venues included in its execution policy.

Demonstration of execution of orders in accordance with execution policy

(1) A firm must be able to demonstrate to its clients, at their request, that it has executed their orders in accordance with its execution policy.

(2) [deleted]

and article 25(5) of the UCITS implementing Directive

Duty of portfolio managers, receivers and transmitters and management companies to act in clients' best interests

A firm must, when providing the service of portfolio management, comply with the obligation to act in accordance with the best interests of its clients when placing orders with other entities for execution that result from decisions by the firm to deal in financial instruments on behalf of its client.

A firm must, when providing the service of reception and transmission of orders, comply with the obligation to act in accordance with the best
In order to comply with the obligation to act in accordance with the best interests of its clients when it places an order with, or transmits an order to, another entity for execution, a firm must:

1. take all reasonable steps to obtain the best possible result for its clients taking into account the execution factors. The relative importance of these factors must be determined by reference to the execution criteria and, for retail clients, to the requirement to determine the best possible result in terms of the total consideration (see COBS 11.2.7 R).

   A firm satisfies its obligation to act in accordance with the best interests of its clients, and is not required to take the steps mentioned above, to the extent that it follows specific instructions from its client when placing an order with, or transmitting an order to, another entity for execution;

2. establish and implement a policy to enable it to comply with the obligation to take all reasonable steps to obtain the best possible result for its clients. The policy must identify, in respect of each class of instruments, the entities with which the orders are placed or to which the firm transmits orders for execution. The entities identified must have execution arrangements that enable the firm to comply with its obligations under this section when it places an order with, or transmits an order to, that entity for execution;

3. provide appropriate information to its clients on the policy established in accordance with paragraph (2);

4. monitor on a regular basis the effectiveness of the policy and, in particular, the execution quality of the entities identified in that policy and, where appropriate, correct any deficiencies; and

5. review the policy annually. This review must also be carried out whenever a material change occurs that affects the firm’s ability to continue to obtain the best possible result for its clients.

This section is not intended to require a duplication of effort as to best execution between a firm which provides the service of reception and transmission of orders or portfolio management and any firm to which that firm transmits its orders for execution.

The provisions applying to a firm which places orders with, or transmits orders to, other entities for execution (see COBS 11.2.30 R to COBS 11.2.33 G) will not apply when the firm which provides the service of portfolio...
management or collective portfolio management and/or service of reception and transmission of orders also executes the orders received or the decisions to deal on behalf of its client's portfolio. In those cases the requirements of this section for firms who execute orders apply (see COBS 11.2.1 R to COBS 11.2.29 R).