

## Chapter 11

# Dealing and managing

## 11.2 Best execution for AIFMs and residual CIS operators

### Application

- 11.2.-7** **G** 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*, in accordance with ■ COBS 18.5A.3R.
- 11.2.-6** **G** 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*.
- 11.2.-5** **G** In accordance with ■ COBS 18.5A.8R, only the following provisions of this section apply to a *full-scope UK AIFM*:
- 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.
- 11.2.-4** **G** 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).

**Modifications**

- 11.2.-3 **G** 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 **G** 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 **G** 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 **R** 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. See 'CESR Questions & Answers: Best Execution under MiFID', May 2007, Ref: CESR/07-320]

- 11.2.1A **R** [deleted]

**Application of best execution obligation**

- 11.2.2 **G** The obligation to take all reasonable steps to obtain the best possible result for its *clients* (see ■ COBS 11.2.1 R) should apply to a *firm* which owes contractual or agency obligations to the *client*.
- 11.2.3 **G** [deleted]
- 11.2.4 **G** 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.

**11.2.5** G 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*.

**11.2.5A** G

### Best execution criteria

**11.2.6** R 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

**11.2.7** R 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.

**11.2.8** G 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*.

- 11.2.9 **G** 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

- 11.2.10 **R** 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.

- 11.2.11 **G** 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*.

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

- 11.2.13 **G** 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

- 11.2.14 **R** 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.

- 11.2.15** **R** 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.
- 11.2.16** **G**
- (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*.
- 11.2.17** **G** 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.
- 11.2.18** **G** 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** .....
- 11.2.19** **R**
- (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.
- 11.2.20** **G** 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.

- 11.2.21** **G** 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

- 11.2.22** **R** A *firm* must provide appropriate information to its *clients* on its order execution policy.

- 11.2.23** **R**
- (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.

- 11.2.23A** **R** A *full-scope UK AIFM* 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.

- 11.2.24** **R** 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

- 11.2.25** **R** (1) A *firm* must obtain the prior consent of its *clients* to the execution policy.

		(2) [deleted]
		(3) [deleted]
11.2.26	R	A <i>firm</i> must obtain the prior express consent of its <i>clients</i> before proceeding to execute their orders outside a <i>regulated market</i> or an <i>MTF</i> . The <i>firm</i> may obtain this consent either in the form of a general agreement or in respect of individual transactions.
		<b>Monitoring the effectiveness of execution arrangements and policy</b>
11.2.27	R	A <i>firm</i> 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 <i>execution venues</i> included in the order execution policy provide for the best possible result for the <i>client</i> or whether it needs to make changes to its execution arrangements. The <i>firm</i> must notify <i>clients</i> of any material changes to their order execution arrangements or execution policy.
		<b>Review of the order execution policy</b>
11.2.28	R	<div>(1) A <i>firm</i> must review annually its execution policy, as well as its order execution arrangements.</div> <div>(2) This review must also be carried out whenever a material change occurs that affects the <i>firm's</i> ability to continue to obtain the best possible result for the execution of its <i>client</i> orders on a consistent basis using the venues included in its execution policy.</div>
		<b>Demonstration of execution of orders in accordance with execution policy</b>
11.2.29	R	<div>(1) A <i>firm</i> must be able to demonstrate to its <i>clients</i>, at their request, that it has executed their orders in accordance with its execution policy.</div> <div>(2) [deleted]</div> <div>and article 25(5) of the <i>UCITS implementing Directive</i></div>
		<b>Duty of portfolio managers, receivers and transmitters and management companies to act in clients' best interests</b>
11.2.30	R	A <i>firm</i> must, when providing the service of <i>portfolio management</i> , comply with the obligation to act in accordance with the best interests of its <i>clients</i> when placing orders with other entities for execution that result from decisions by the <i>firm</i> to deal in <i>financial instruments</i> on behalf of its <i>client</i> .
11.2.31	R	A <i>firm</i> must, when providing the service of reception and transmission of orders, comply with the obligation to act in accordance with the best



interests of its *clients* when transmitting *client* orders to other entities for execution.

**11.2.32** **R** 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*.

**11.2.32A** **R** [deleted]

**11.2.33** **G** 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.

**11.2.34** **R** 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).