Financial Conduct Authority

Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Best execution arrangements in investment managers – multi-firm feedback

Lead regulator: FCA

Date of assessment: 27 March 2017

Commencement date: The findings article was published on 3 March 2017. The relevant applicable rules have been in force since January 2006.

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? All investment management firms that executes orders on behalf of clients or transmit these orders to third parties for execution.

Brief outline of proposed new or amended regulatory activity

Our rules set clear criteria on what firms need to do in order to provide their customers with best execution on a consistent basis. In July 2014 we published a thematic review on best execution and payment for order flow (TR14/13). While the report focused on brokers and wealth managers it stated that the findings were relevant to all firms who execute and transmit orders.

Our 2016 review (which the 3 March 2017 publication communicated the findings of) aimed to establish what impact the 2014 review had had on buy side firms.

The article was published on the FCA website and set out instances where we believe control and governance structures made it difficult to provide meaningful oversight of firms best execution practices. Our statements did not go further than what we had said in previous thematic publications (TR14/13), in fact it reiterated that firms need to review the original thematic document.

Which type of business will be affected? How many are estimated to be affected?

While this publication is relevant for all investment managers that execute trades (or send them to a third party to execute), our statements did not go over and above what we have publicly stated in the past. We therefore believe there is a zero cost associated with this. However, there will be a cost related to reading, comprehending and disseminating this information. We estimate that the number of firms this publication is relevant for will be circa 3,000 firms.

Price base year	**Implementation date**	**Duration of policy (years)**	**Business Net Present Value**	**Net cost to business (EANDCB)**	**BIT score**
2017	2017	10	-0.11	0	0

Please set out the impact to business clearly with a breakdown of costs and benefits

Note – for all cost estimates below we have assumed the changes will be applied by experienced compliance staff at an estimated rate of £48/hour. The 2016 Robert Half salary guide estimates that a compliance manager in the risk and compliance function of a financial services company based in London earns between £70,000 and £104,000 per annum. Based on working 8 hours per day for 260 days each year our rate equates to £100,000 per annum and is therefore considered a suitably prudent figure for the purposes of our estimates.

Familiarisation cost and Gap Analysis cost
There are approximately 870 words in the article. We expect that all of the approximately 3000 investment management firms would find it helpful to familiarise themselves with the article[1]. We would expect that the note would take up to 45 minutes to read, digest, disseminate to relevant members of staff, and, if necessary, update the relevant procedure to reflect the guidance. We would not expect there to be any cost to firms which are already compliant with the underlying rule (although to be prudent we have included all of the estimated 3000 companies in our calculations below)[2].

The total estimated cost for all 3000 investment management firms would be approximately £108,000. This is an estimate of the maximum amount of time it might take a company to review the article as the note provides illustrative examples of good practices.

The 3,000 firms is an approximation based on firms supervised in the [name] department and firms we know are supervised outside the department with the permissions to execute trades (or permission to receive and transmit orders which also has best execution obligations). We have cross checked against internal databases which are not able to give precise data Best execution rules apply to most of our firms no matter the size of the firm or the financial instrument (as defined by MIFID) that they trade.

Ongoing cost

We consider that this publication creates no ongoing costs for business because the expectations set out in it are wholly inherent in the existing rules and add no new obligations to those rules for any firms.

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[1] https://www.fca.org.uk/news/news-stories/investment-managers-still-failing-ensure-effective-oversight-best-execution

[2] *We arrived at the one hour estimate based on the following calculation. The two page technical note contains 870 words. The speed of reading technical text is 50-100 words per minute based on EFTEC (2013), "Evaluating the cost savings to business revised EA guidance - method paper" the time remaining to digest, disseminate the information and if necessary update the relevant procedures is based on our broader supervisory knowledge of how firms respond to our Technical Notes and also on supervisory conversations with firms about their procedures relating to this specific issue*

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

The table below maps a [representative sample] of recommendations in th article against existing rules/guidance

Our findings / expectations	Existing rules / guidance
Firms should have a strategy to ensure that all relevant parts of the business are compliant in ensuring best execution. There should be clear management responsibility and co-ordination between the front office and compliance to ensure a robust monitoring framework. We were concerned to find that most firms had failed to take on board the findings of our thematic review. The pace of change in improving client outcomes in best execution was slow, with few firms have a cohesive strategy for improving client outcomes.	**COBS 11.2.1** **TR 14/13**[3] (page 3) - one of the main messages from this review was: Most firms are not doing enough to deliver best execution through adequate management focus, front-office business practices or supporting controls. ☐ Firms need to improve their understanding of the scope of their best execution obligations, the capability of their monitoring and the degree of management engagement in execution strategy, if they are to meet our current requirements.
We did see some good practice in firms where best execution was considered throughout the investment decision making process and not just the dealing desk. Some dealing teams provided feedback to portfolio managers on their preferred trading strategies.	**COBS 11.2.30** 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* or, for a *management company*, *collective 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*.
Firms showing good practice had an effective governance process in place that challenged the overall costs of execution, renegotiated commissions and identified trends that helped improve future execution, which fed into a high level trading strategy.	**COBS 11.2.7** 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,

[3] https://www.fca.org.uk/publication/thematic-reviews/tr14-13.pdf

	clearing and settlement fees and any other fees paid to third parties involved in the execution of the order.
All the firms we visited had management information that allowed them to accurately view equity execution costs, however use of these data was inconsistent. Some firms could not evidence any improvement in their execution process based on these data and the review of it was largely a 'tick box' exercise.	Finding similar to the one raised in **TR14/13** (page 5). It was often unclear how monitoring was captured in management information and used to inform action to correct any deficiencies observed by firms. Page 24 We observed little in the way of supervisory oversight which resulted in the escalation of issues through the use of appropriate management information. This limited the ability of firms to take broader corrective action where comparable issues that required client remediation were identified.
MIFID II places a specific obligation on firms to check the fairness of prices proposed to clients when executing orders or taking decisions to deal in OTC products. Therefore to ensure MIFID II readiness and future compliance with our rules, firms will need to improve current practices in relation to these types of trades.	**TR 14/13** page 4 All firms also need to prepare for the challenges of MiFID II implementation in this area. Page 6 Additional obligations in the recast Markets in Financial Instruments Directive (MiFID II) are intended to address some of the specific weaknesses observed in this work, in particular regarding the adequacy of monitoring. Therefore firms need to improve their current systems and controls and be ready for the implementation of future policy change. These improvements will need to be broadly applied, since the new obligations under MiFID will enhance reporting requirements across all relevant asset classes.
We found instances where compliance staff were not empowered by senior management in order to provide effective challenge to the front office on execution quality. Sometimes they lacked access to the data used by the dealing team or they didn't use data already available such and gifts and entertainment logs. This led to a 'tick box' monitoring process where failings were unlikely to be discovered.	**TR 14/13** pages 23 & 24 Overall, we found most firms lacked effective monitoring and were unable to demonstrate that their monitoring arrangements were capable of, or indeed ever had, identified best execution failures or poor client outcomes. Moreover, firms could rarely point to changes being made to their execution arrangements to address issues identified through their monitoring. We also found that monitoring activities were often undertaken in silos, with firms not being able to effectively explain how different

	checks and processes related to one another or supported management oversight and governance to help drive consistent delivery of best execution. In addition, most firms lacked effective independent challenge to the front-office, or had implemented only a formalised 'tick-box' process, which added little value to delivering best execution. The second line of defence generally played a limited or non-existent role in challenging the conclusions reached by front-office monitoring.
Who would the FCA hold responsible if the firm fails in its obligations to ensure it consistently achieves best execution?	**TR 14/13** page 5 Accountability: It was often unclear who had responsibility and ultimate accountability for ensuring that execution arrangements and policies met our requirements.
Do we have a comprehensive strategy for overseeing best execution?	**TR 14/13** page 3 Firms need to improve their understanding of the scope of their best execution obligations, the capability of their monitoring and the degree of management engagement in execution strategy, if they are to meet our current requirements. Page 26 Some firms' monitoring included liquidity, toxicity and reversion analysis and those firms were able to demonstrate how this material was used to set execution venue strategy.
Have we tested that funds are client portfolios are not paying too much for execution? Where we have identified they have paid too much did we compensate the investors?	**DISP 1.1.2** If there has been a failure to give compliant and proper advice, or some other breach of the duty of care, the basic objective of redress is to put the complainant, so far as is possible, in the position he would have been in if the inappropriate advice had not been given, or the other breach had not occurred.
Does our order execution policy accurately reflect our firms business model rather than being generic?	**COBS 11.2.22** A *firm* must provide appropriate information to its *clients* on its order execution policy. **COBS 11.2.23** 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: 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; 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; 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.
What trades or trends have been identified through our regular monitoring?	**TR 14/13 page 23** Overall, we found most firms lacked effective monitoring and were unable to demonstrate that their monitoring arrangements were capable of, or indeed ever had, identified best execution failures or poor client outcomes. Moreover, firms could rarely point to changes being made to their execution arrangements to address issues identified through their monitoring.
Is our gifts and entertainment policy in line with the guidance set out in our finalised guidance 14/1 and the FSA's 2012 Dear CEO letter?	Reference to go and review previously published work.
Have our staff been adequately trained to ensure they understand what best execution means and its consequences? Howe can we evidence this to the FCA?	**TC 2.1.11** *Firms* should ensure that their *employees'* training needs are assessed at the outset and at regular intervals (including if their role changes). Appropriate training and support should be provided to ensure that any relevant training needs are satisfied. *Firms* should also review at regular intervals the quality and effectiveness of such training. **SYSC 3.1.9**

	Firms which are carrying on activities that are not subject to *TC* may nevertheless wish to take *TC* into account in complying with the competence requirements in *SYSC*.