



GUIDE TO BEST EXECUTION

References: Articles L. 533-18 to L. 533-18-2 of the Monetary and Financial Code and Articles 64 to 66 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016

Introduction

This guide is an update of Position-Recommendation No. 2014-07.

Following the transposition of the MiFID II legislation, a number of new measures relating to best execution were adopted, while others became obsolete. In this context it seemed worthwhile assessing the practices of investment services providers (ISPs) in order to identify areas of weakness and risk and to clarify the conditions of practical application of the legislative and regulatory provisions regarding best execution.

The guide also draws on a Questions and Answers document (hereinafter "CESR Q&A") **published by the CESR in May 2007**,¹ which was the subject of a **news release published** on 30 October 2007, in which the AMF called on professionals to refer to the CESR recommendations. Where appropriate, the recommendations expressed in the **CESR Q&A remain applicable**. Therefore, some of the recommendations made in this guide draw on comments made in the CESR Q&A.

This guide also draws on the ESMA document entitled "*Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics*" (hereinafter referred to as the "ESMA Q&A") which contains clarifications on the best execution obligations in its Section 1.

Finally, note that the document entitled "*Questions and answers relating to the provision of CFDs and other speculative products to retail investors under MiFID*" provides a set of clarifications, notably regarding the application of the best execution obligations to trading by retail clients in CFDs and binary options, and rolling spot forex transactions, which are referred to in this guide.

This guide has three objectives:

- ensure that investors receive the protection to which they are entitled;
- suggest simple principles for ISPs to help them implement the arrangements best suited to their strategy, business and clients;
- provide clear guidelines on how the AMF expects best execution rules to be applied.

Since the provisions in the guide merely clarify rules that are already in force, they are applicable immediately.

¹ *Best Execution under MiFID, Reference 07-320. The AMF has prepared a French translation.*

This translation is for information purpose. Only the version published in French on the AMF web site the 27th of July 2020 is authoritative

1. SCOPE

1.1. Clients

Article L. 533-20 of the Monetary and Financial Code transposing Article 30 of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 (hereinafter the "**MiFID II directive**") specifies that transactions brought about or entered into with eligible counterparties are not subject to certain rules of business conduct, including the best execution obligation.

Accordingly, this guide does not pertain to relations with eligible counterparties.

1.2. Financial instruments and transactions

Recital 104 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016² (hereinafter "**MiFID II DR**") stipulates that the best execution obligation applies to all types of financial instruments but that it should however be applied in a way that takes account of "differences in market structures or the structure of financial instruments". In other words, the best execution obligation should be applied taking account of the specific features of different types of financial instruments.

Moreover, Recital 99 of MiFID II DR³ describes in more detail how the best execution obligation is intended to apply to securities financing transactions. Article 64(1)(b) of MiFID II DR specifies, in this respect, that ISPs should take into account the criteria for determining the relative importance of the best execution factors, and in particular "the characteristics of the client's order, including the fact that the order involves a securities financing transaction".

Unless otherwise stated with reference to a specific asset class, the recommendations/positions and rule reminders in this guide apply to all financial instruments.

Except in sections 2.1.1. and 2.1.4.2., the guide does not deal specifically with securities financing transactions.

² Recital 104 of MiFID II DR: "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 investment firm may not be comparable for best execution purposes with transactions involving shares traded on centralised execution venues."

³ Excerpts from Recital 99 of MiFID II DR: "In order to comply with the legal obligation of best execution, investment firms, when applying the criteria for best execution for professional clients, will typically not use the same execution venues for securities financing transactions (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 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. As a result, the order execution policy established by investment firms should take into account the particular characteristics of SFTs and it should list separately execution venues used for SFTs."

1.3. Market participants concerned

In this guide, the expression "**investment services provider**" refers not only to investment firms, credit institutions that have received an authorisation to provide investment services, but also to asset management companies when they provide an investment service and market undertakings when they operate an organised trading facility.⁴ Unless otherwise specified, this is the population to which this guide applies.⁵

1.4. Investment service provided

The best execution principle is applied taking into account the service provided by the investment services provider:⁶

- It applies in full to investment services providers that execute orders or, as part of the provision of the portfolio management service, to investment services providers that execute decisions to deal;

Regarding this, the AMF gives a reminder, in accordance with Recital 103 of MiFID II DR, that "dealing on own account with clients by an investment firm should be considered as the execution of client orders, and therefore subject to the requirements under Directive 2014/65/EU and this Regulation and, in particular, those obligations in relation to best execution ". Moreover, this recital should be read in light of the European Commission response⁷ to the CESR, which states that:

"Application or otherwise of best execution will depend on whether the execution of the client's order can be seen as truly done on behalf of the client. This is a question of fact in each case which ultimately depends on whether the client legitimately relies on the investment firm to protect his or her interests in relation to the pricing and other elements of the transaction – such as speed or likelihood of execution and settlement – that may be affected by the choices made by the firm when executing the order. [...]"

(1) whether the firm approaches (initiates the transaction with) the client or the client instigates the transaction by approaching the firm. In those cases where the firm approaches a retail client and suggests that they 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.

(2) 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.

⁴ See Article L. 425-3 of the Monetary and Financial Code.

⁵ Note that collective investment management is subject to different rules (Article L. 533-22-2-2 of the Monetary and Financial Code). See also the Guide to MiFID II for asset management companies (fact sheet No. 10) published on 16 March 2016.

⁶ This does not prevent investment services providers subject both to the best execution provisions for part of their transactions and to best selection for another part, from reporting on the methods for handling these transactions in the same single report issued in accordance with RTS 28, on condition that said report contains two separate sections corresponding to each of these methods of operation.

⁷ Commission response 1 (paragraph 8) to question 1 "Dealing on quotes" appended to the CESR Q&A. Commission response (working document CEVM-ESC-07-2007) available in an appendix to the aforementioned "CESR Q&A" (CESR/07-320) via the ESMA website and/or the following web link: https://www.esma.europa.eu/sites/default/files/library/2015/11/07_320.pdf (in English). In May 2007 the AMF staff proposed the translation of the document (in French) available on its website from the following web link: <https://www.amf-france.org/Reglementation/Textes-europeens/Epargne-et-prestataires/OPCVM/Meilleure-execution-dans-le-contexte-de-la-directive-MIF---Questions---Reponses-du-CESR>

(3) 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 easily reached that they rely on the firm in relation to the pricing of the transaction.

(4) 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."

It should also be noted that the definition of **execution of orders on behalf of clients** was broadened under MiFID II and now includes entering into agreements for the buying or selling of financial instruments issued by an investment firm or a credit institution at the time of their issue.⁸

As a consequence, the best execution requirements shall be appropriately applicable to this type of transaction;⁹

- It also applies, appropriately, to investment services providers providing the portfolio management service for third parties¹⁰ that transmit orders arising from their own decisions to deal and to investment services providers providing a service of reception and transmission of orders when they transmit to other entities for execution orders that they have received and do not execute themselves. It should be remembered that the provisions relating to the selection policy do not apply to investment services providers providing the portfolio management service for third parties that execute themselves the decisions to deal that they take on behalf of the clients whose portfolios they manage (Article 65(8) of MiFID II DR): in that case, they must comply with the best execution provisions. To avoid duplicating best execution efforts,¹¹ investment services providers that transmit or place orders with other entities for execution must prepare and implement a "selection policy".¹² The corresponding obligations are referred to as "best selection" obligations in the remainder of this guide;

- It also applies to the service of operation of an organised trading facility managed by a market undertaking or an ISP authorised for the operation of an organised trading facility (hereinafter "**OTF**").¹³

1.5. Instructions received

In accordance with Articles L. 533-18, I of the Monetary and Financial Code and 65(4) paragraph 2 of MiFID II DR, wherever there is a specific instruction given by the client, the intermediary shall execute or transmit the order in accordance with said instruction. However, if a client has given a specific instruction that covers only one portion or aspect of the order, the investment services provider must comply with its best execution (or best selection) obligation for any other portion or aspect of the order not covered by such instructions.¹⁴

The specific instruction may refer to an execution venue or any other characteristic of the order.

⁸ Article D. 321-1, 2 of the Monetary and Financial Code.

⁹ The requirements of the specific instructions are also applicable in the primary market.

¹⁰ This guide does not apply to collective investment management activities, which are subject to the provisions of the UCITS or AIFM directives.

¹¹ Recital 106 of MiFID II DR: "This Regulation should not require a duplication of effort as to best execution between an investment firm which provides the service of reception and transmission of orders or portfolio management and any investment firm to which that investment firm transmits its orders for execution."

¹² The former Article 314-75 of the AMF GR which transposed Article 45(5) of the Delegated Directive of 10 August 2006 uses the concept of "selection" ("this policy selects"), whereas now Article 65(6) of MiFID II DR uses the term "identification" ("this policy identifies"). For instructive purposes, however, the selection policy concept is retained in this document.

¹³ Article L. 425-3 of the Monetary and Financial Code.

¹⁴ Recital 102 of MiFID II DR.

Outline of the guide. - This guide covers, in Section 2, the provisions applicable with regard to best execution, and in Section 3 the provisions applicable with regard to best selection.

Sections 4 and 5 deal with the link between research and selection and payment for order flow, respectively.

2. PROVISIONS RELATING TO BEST EXECUTION

The best execution obligation is defined in Article L. 533-18, I of the Monetary and Financial Code as the requirement for investment services providers "to take all sufficient steps when executing orders to obtain the best possible result for their clients".

Note that the MiFID II directive is more demanding than MiFID I in that it is from now on required that the investment services provider takes all sufficient steps (and no longer reasonable steps).¹⁵

Moreover, this interpretation is confirmed by question 1.1 of the ESMA Q&A which states that "*the requirement for "sufficient" steps sets a higher bar for compliance than "reasonable" steps.*"¹⁶ This means that it is expected of investment services providers that they check on an ongoing basis that the best execution steps that they have taken function correctly throughout the various stages of order execution, and that they be capable of remediating any detected shortcoming.

In accordance with the aforementioned article, the best possible result is assessed on the basis of seven factors: "cost, price, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order".

Under Article 64(1) of MiFID II DR, investment services providers should determine the relative importance of these factors based on a series of criteria that consider "the characteristics of the clients, including their status as professional or retail clients", "the characteristics of the order concerned", "the characteristics of the financial instruments covered by the order", and "the characteristics of the execution venues to which the order may be routed".

2.1. Preparation of the execution policy

In accordance with Article L. 533-18 (II) of the Monetary and Financial Code, compliance with the best execution obligation is achieved by implementing order execution arrangements and a policy that enable investment services providers to obtain the best possible result for client orders.

Answer 5 in the CESR Q&A of May 2007 states that "'execution arrangements' are the means that an investment firm employs to obtain the best possible result when executing orders or decisions to deal, while the 'execution policy' may be understood as a document that describes the most important and/or relevant elements of those execution arrangements."

2.1.1. To what extent should the execution policy be differentiated?

Article 64(1) of MiFID II DR states that to determine their execution policy, and notably the relative importance of the factors used to assess best execution, investment services providers shall take into account, in particular, the characteristics of the client, the characteristics of the client order, the characteristics of financial instruments that are the subject of that order, and the characteristics of the execution venues to which that order may be routed.

Moreover, as a reminder, Articles 64(1) and 66(3)(b) of MiFID II DR stipulate that the order execution policy employed by investment services providers should take into account the particular characteristics of securities financing transactions and it should list separately the execution venues used for those transactions.

¹⁵ This is a Strengthened obligation in terms of means.

¹⁶ ESMA, Questions and answers on MiFID II and MiFIR investor protection topics, Best execution, Q&A No. 1.

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Lastly, in accordance with Article 64(1) mentioned above, investment services providers shall take into account the categorisation of the client as retail or professional when establishing their execution policy.

Recommendation

The AMF recommends that, in accordance with Article 64 of MiFID II DR, the investment services provider establish a more granular classification within a particular client category if it feels it is appropriate to tailor its execution policy more closely to its clients' knowledge and experience.

2.1.2. Factors of the execution policy

In accordance with Article L. 533-18 (I) of the Monetary and Financial Code, the factors to be taken into account by the investment services provider in order to obtain the best possible result for its client are as follows: the cost, price, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. The same article specifies, moreover, that "when investment services providers [...] execute orders for retail clients, the best possible result is determined on the basis of the total cost."

As a reminder, the total cost is defined in Article L. 533-18, I of the Monetary and Financial Code which specifies that "the total cost is the price of the financial instrument, plus the costs relating to execution, including all the expenses incurred by the client that are directly linked to the execution of an order, along with the charges specific to the execution venue, clearing and settlement charges and all other charges that may be paid to third parties participating in the execution of an order."

In addition to the seven factors listed above, the investment services provider may take into account "other considerations relevant to execution of the orders" mentioned in Article L. 533-18 (I) of the Monetary and Financial Code, i.e. qualitative factors.

Article 66(3)(c) of MiFID II DR specifies, in this regard, that clearing schemes, circuit breakers, scheduled auctions, or any other relevant consideration are all qualitative factors which may be used to select an execution venue.

Recommendation

In addition to the factors mentioned above, the AMF suggests a non-exhaustive list of qualitative factors that may be taken into account in the execution policy, depending on the category of clients concerned (professional or retail clients), such as the transparency of the price formation process (pre-trade), the simplicity of execution mechanisms, the diversity of services provided (extended trading hours, types of orders offered) and the ability to provide clients with complete and intelligible information on execution mechanisms. If the investment services provider has concerns about the reliability and robustness of an execution venue and/or its sustainability, it may legitimately consider that this could impact its ability to deliver best execution to its client and accordingly exclude the venue from its execution policy.

Another factor that may be relevant to professional clients is implementation shortfall, an indicator used to measure an order's impact on the market. For some professionals, this factor may be more important than speed of execution.

However, when including qualitative criteria in the execution policy for retail clients, it should be remembered that total cost is the most important criterion for this category. That said, Recital 101 of MiFID II DR permits other criteria to be given precedence insofar as "they are instrumental in delivering the best possible result in terms of the total consideration to the retail client".

2.1.3. Determining the execution venues to include in the execution policy

For the purposes of Article 64(1) of MiFID II DR, an 'execution venue' includes a regulated market, an MTF, an OTF, a systematic internaliser, a market maker or other liquidity provider,¹⁷ or an entity that performs similar functions in a third country.

Article 66(3)(b) of MiFID II DR stresses that investment services providers' execution policy shall give details on the execution venues "on which the firm places significant reliance in meeting its obligation to take all [sufficient] reasonable steps to obtain on a consistent basis the best possible result for the execution of client orders".

In particular, pursuant to the aforementioned article, when drawing up the list of execution venues to which client orders are routed, the investment services provider shall distinguish between execution venues for professional clients and retail clients. It shall also, in accordance with the same article, differentiate these execution venues by category of financial instrument.

Furthermore, Article 64(3) of MiFID II DR stipulates that investment services providers shall not "structure or charge their commissions in such a way as to discriminate unfairly between execution venues."¹⁸

Recommendation

Consistent with answer 12.2 provided in the CESR Q&A, the AMF recommends that when selecting venues to be included in its execution policy, the investment services provider should focus on the potential of the venues to enable it to obtain on a consistent basis the best possible result for the execution of its client orders; it should not take account of the fees and commissions it will charge its clients.

However, Q&A answer 8.2 introduces the idea, which is still valid, that the investment services provider should also consider the costs of including an execution venue in its policy, to the extent that these costs are passed on to clients, and should compare these to the improvement in terms of execution quality. These integration costs should include the cost and any operational risk entailed in adapting front office systems (connection of the new execution venue to trading systems) and back office systems (settlement chains).

As a result, investment services providers should examine all venues on which they are likely to execute client orders, without taking into account the fees and commissions they will charge; but in terms of their policy execution, they are not required to include venues for which the gain obtained could be outweighed by the costs (where these are passed on to clients) arising from the inclusion of these new venues in the policy.

In accordance with Recital 108 of MiFID II DR, the execution policy may include only a single execution venue provided that investment services providers are "able to show that this allows them to obtain best execution for their clients on a consistent basis" and 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".

ESMA also confirmed this possibility in question and answer 3 regarding best execution in the ESMA Q&A.

2.1.4. What should an execution policy contain?

¹⁷ See question and answer 18 in section 1 of the ESMA Q&A.

¹⁸ Whereas, at level 1, the "execution platform" concept has been replaced by "execution venue", the level 2 texts still refer to the "execution platform" concept. The "execution venue" concept will therefore be used in the remainder of this guide.

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As a reminder, the content of an execution policy is described in articles L. 533-18, III of the Monetary and Financial Code, and 66(2) and 66(3) of MiFID II DR.

For the purposes of Article L. 533-18 (III) of the Monetary and Financial Code, the execution policy shall include, for each category of financial instruments, information on the different execution venues on which the investment services provider will execute its clients' orders and the factors influencing the choice of execution venue. Said information shall cover at least the execution venues that enable the service provider to obtain, on a consistent basis, the best possible result from execution of clients' orders.

Note that Article 66(3) of MiFID II DR extended the list of information to appear in the execution policy. Accordingly, the execution policy should now include, in addition to the information already stipulated under MiFID I,¹⁹ the following indications:

- a list of factors used to select an execution venue, and the relative importance of each factor, or the process by which the firm determines the relative importance of those factors;²⁰
- how the execution factors of price, costs, speed, likelihood of execution and any other relevant factors are considered as part of all sufficient steps to obtain the best possible result for the client;²¹
- where applicable, information that the firm executes orders outside a trading venue, the consequences, for example counterparty risk arising from execution outside a trading venue, and upon client request, additional information about the consequences of this means of execution;²² and
- a summary of the selection process for execution venues, execution strategies employed, the procedures and process used to analyse the quality of execution obtained and how the firms monitor and verify that the best possible results were obtained for clients.²³

2.1.4.1. General

Whatever the financial instruments traded – including those traded mostly over-the-counter – and the client category, the AMF reiterates that the items mentioned above should be included in the execution policy.

For the other items, the investment services provider is free to determine the content of its execution policy. Consistent with CESR Q&A answer 4.3, the AMF notes that the investment services provider may, however, in certain cases, use venues not included in its policy, for example on a provisional basis at its own initiative with a view to satisfying the best execution requirement, or to accommodate a client request to trade in an unusual instrument.

2.1.4.2. Specific cases

The specific case of OTC execution. –

Recommendation

According to the AMF, where the execution policy provides for the possibility of OTC execution, it should specify the execution arrangements so that the investor understands how his or her orders are executed (OTC trade

¹⁹ Points a), b) and f) of Article 66(3) of MiFID II DR.

²⁰ Point c) of Article 66(3) of MiFID II DR.

²¹ Point d) of Article 66(3) of MiFID II DR.

²² Point e) of Article 66(3) of MiFID II DR.

²³ Point g) of Article 66(3) of MiFID II DR.

with the investment services provider dealing on own account or with another counterparty). In the latter case, moreover, the policy should give details of the counterparty selection process.

Specific case of instruments traded on an organised trading facility (OTF) operated by an ISP or a market undertaking. –

In its Q&A 13 (section 1), ESMA:

- reiterates that the ISP or market undertaking operating an OTF should describe how orders are carried out at the level of the ISP and at the level of the OTF and, in particular, how discretion is exercised at each stage.
- states that, in particular, the ISP or market undertaking should, when setting out its execution policy, specify the various execution venues, including its own OTF, that could be used.
- also specifies that the ISP or market undertaking should have either a separate policy for order processing or an additional section in the execution policy demonstrating how, when a client order is sent to the OTF, the best possible result for the client is achieved. Regarding this, he or she shall also take into account the trading interests in the system and the different execution mechanisms that may be available on the OTF, such as voice execution, electronic RFQ or order book.

Recommendation

The AMF recommends that the investment services provider comply with the provisions of this ESMA Q&A regarding the financial instruments traded on an OTF.

Specific case of CFDs and warrants/certificates. -

In the case of CFDs, warrants/certificates, and, more generally, financial instruments that are designed to capture the performance of an independently traded underlying asset and that are intended for retail clients, the execution policy should detail the price formation process. Moreover, pursuant to Article 48(1) of MiFID II DR, the ISP should provide its client with “a general description of the nature and risks of financial instruments” and notably (Article 48(2)(b) of MiFID II DR)²⁴ specific information concerning the sensitivity of the price to changes in various market parameters. The information specific to these products may be supplied to clients on a variety of materials (product sheet, etc.).

Pursuant to Article 48(2)(a) of MiFID II DR, the investment services provider shall also provide its clients with, in particular, an explanation of leverage and its consequences.

Furthermore, pursuant to Article 48(2) (d) and (e) of MiFID II DR, in the specific case of CFDs, the service provider shall describe the nature of the specific risks due to margin requirements or similar obligations applicable to such instruments and, where applicable, underline the existence of a risk of a loss exceeding the capital invested.

Position

As regards these instruments, the execution policy should specify:

- **execution procedures, explaining how orders are executed and by whom;**

²⁴ Article 48(2)(b) of MiFID II DR: 2° The volatility of the price of such instruments and any limitations on the available market for such instruments.

- price formation procedures, notably indicating the reference market.

Specific case of securities financing transactions. -

Pursuant to Article 66(3)(b) of MiFID II DR²⁵, in the case of securities financing transactions the information on the execution policy employed by the investment services provider shall distinguish between the execution venues used for these transactions and those used for other financial instrument transactions.

2.2. Implementation of the execution policy

In accordance with Article L. 533-18 (II) of the Monetary and Financial Code, investment services providers shall "establish and implement an order-execution policy that enables them to obtain the best possible result for their clients' orders". It is this implementation and hence the compliance with this policy that enables them in particular to meet their obligation of taking all sufficient steps to obtain the best possible result for the execution of their clients' orders.

Therefore, compliance with the execution policy established and supervised in accordance with the provisions set out in this guide is a constituent part of compliance with the general obligation of best execution.

However, pursuant to Article 64(2) of MiFID II DR, the investment services provider fulfils the aforementioned obligation 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.

Paragraph 1(3) of the same article also states that in order to ensure the best possible result when several rival execution venues are capable of executing an order concerning a financial instrument, investment services providers shall assess and compare the results that would be obtained for clients by executing the order in each of the execution venues included in the execution policy whenever they are capable of executing that order. In making this assessment, investment services providers shall take into account the specific fees and costs for execution of the order in each of the eligible execution venues.

For the application of best execution to OTC transactions, Article 64(4) of MiFID II DR stipulates that "when executing orders or taking decisions to deal in OTC products, including bespoke products, the investment firm shall 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 or comparable products."

The answer to question 2 of section 1 of the ESMA Q&A specifies that this check should be performed by gathering market data used in the estimation of the price of such products and, where possible, by comparing with similar or comparable products.

This Q&A adds that:

- firms, as a matter of practice, may be routinely taking account of external market data and externally verifiable reference prices (where available), when pricing or checking the price of OTC products;
- however, these checks must be undertaken on a systematic basis and embedded in the firms' policies and practices;

²⁵ See also Recital 99 of MiFID II DR.

- as a consequence, firms need to ensure that they have the necessary procedures and arrangements in place as well as appropriate valuation systems. With greater access to technology and data analytics, firms will be expected to scrutinise the methodologies and inputs underpinning any valuation processes and pricing models utilised with respect to OTC products in order to ensure that they are consistently checking the fairness of the price. The same requirements shall apply when they place orders resulting from a trading decision concerning OTC products. If this check is performed ex ante, ESMA requires, for supervision purposes, that investment services providers keep records and/or documents attesting the satisfactory fulfilment of this obligation and demonstrating that the decisions are taken in the client's best interest and are not biased by any conflicts of interest.

Recommendation

The AMF recommends that investment services providers apply the arrangements provided for by this ESMA Q&A to check the fairness of the price for OTC transactions.

2.3. Monitoring and review of the execution policy

2.3.1. Monitoring the effectiveness of order execution arrangements on a regular basis

Article L. 533-18-2 of the Monetary and Financial Code provides that "investment services providers shall supervise the effectiveness of their arrangements for order execution and their policy on this matter in order to detect any deficiencies and to remedy them as appropriate. In particular, they shall periodically verify whether the execution venues stipulated under their order execution policies provide for the best possible result for the client or whether they need to modify their execution arrangements notably in light of the information available pursuant to Articles L. 420-17, L. 533-18-1, L. 533-19 and L. 533-33" of the Monetary and Financial Code.

It should also be noted that pursuant to Recital 107 of MiFID II DR, the information published by the execution venues in accordance with Commission Delegated Regulation (EU) 2017/575 of 8 June 2016 (RTS 27) should be used, *inter alia*, by investment services providers for purposes of regular supervision.

Recommendation

As reiterated in CESR Q&A answer 24, the abovementioned regular supervision is intended to determine whether the investment firm has "complied with its (execution) policy and/or arrangements, and whether the resulting transaction has delivered the best possible result for the client".

As a consequence, the AMF recommends that the Q&A answer 24 be applied, which states that:

- "Monitoring may include comparing similar transactions:

- i) on the same execution venue or with the same entity, in order to test whether a firm's judgement about how orders are executed is correct, or**
- (ii) on different execution venues or entities chosen from among those in the firm's execution policy, in order to test whether the 'best' execution venue or entity is being chosen for a given type of transaction;**

- the monitoring methodology is at the discretion of the firm. Where monitoring every transaction would be disproportionate, other approaches, such as appropriate methodologies for sampling,²⁶ may suffice;

- where monitoring reveals that a firm has fallen short of obtaining the best possible result, the firm should consider whether this is because the firm has failed to follow its execution policy and/or arrangements or because of a deficiency in such policy and/or arrangements, and make appropriate amendments".

²⁶ Sampling checks should be representative and tailored to the firm's business/clientele/size/order types.

A review of customer complaints regarding order execution may also be a way to detect errors in processes and/or parameters.

Examples:

An investment services provider offering access to multiple execution venues must ensure that the parameters of tools such as the Smart Order Router (SOR) comply with the execution policy.²⁷

If one of the important policy factors is a low implementation shortfall, and provided that this is appropriate given the nature of the instrument concerned, the investment services provider should analyse orders executed with a substantial implementation shortfall to see whether this was due to deficiencies in execution arrangements and take corrective measures where appropriate.

Regular monitoring of “the effectiveness of their arrangements for order execution and their policy on this matter in order to detect any deficiencies and to remedy them as appropriate” does not relieve investment services providers of the responsibility for reviewing their execution policies, pursuant to the provisions of Article 66(1) of MiFID II DR.

2.3.2. Review of the execution policy

2.3.2.1. Obligation to review

Article 66(1) of MiFID II DR stipulates that “investment firms shall review, at least on an annual basis, execution policy [...] as well as their order execution arrangements.” It adds that “such a review must also be conducted 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”. Lastly, the investment firm “shall assess whether a material change has occurred and shall consider making changes to the relative importance of the best execution factors in meeting the overarching best execution requirement.”

Recommendation

The AMF recommends that this review be formally recorded in a summary document that reports on the elements covered by the review, the execution venues examined, policy amendments and the reasons for these amendments (or alternatively continued application of the current policy) as well as the arguments supporting the decision to add (or not add) new execution venues (Regulated Markets, MTF, OTF, SI, other brokers, etc.).

On the basis of II (6°) of Article L. 533-10 of the Monetary and Financial Code, the AMF recommends that investment services providers retain the summary documents formally recording the annual review of their execution policy for a period of at least five years.

2.3.2.1.1. Events necessitating a review of the execution policy. –

As a reminder, Article 66(1) of MiFID II DR states that, in addition to its annual review, a review of the execution policy should 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”.

This wording leaves investment services providers considerable latitude to determine their course of action.

Indeed, pursuant to the same article, the investment firm “shall assess whether a material change has occurred and shall consider making changes to the relative importance of the best execution factors in meeting the overarching best execution requirement.”

²⁷ Provided that the use of this tool is appropriate for the financial instrument in question.

Position

The AMF considers that the definition of a "material change" given in the last paragraph of Article 65(7) of MiFID II DR, applicable to the selection policy, can also apply for the purpose of review of the execution policy in the event of a "material change".

Recommendation

Between two annual reviews, the investment services provider must determine whether to review the policy depending on internal or outside events assessed by the firm. Among the elements that might affect its ability to consistently obtain the best possible result for client order execution, the AMF considers that the investment services provider could take account of the following:

- material market incidents;
- material change in the level of costs resulting from connection to a venue;
- change in the scope of financial instruments traded on a venue;
- development of significant new execution procedures or a change in the market model of an existing venue;
- major change to existing arrangements, such as a material change in the human or technical resources that the company relies on to provide best execution;
- client complaints that point to a major problem.²⁸

2.3.2.1.2. Due diligence to be conducted when reviewing the execution policy. –

- (i) For all financial instruments:

Recommendation

The AMF recommends, consistent with answer 23 in the CESR Q&A, that the review of the execution policy should consist of an overall assessment of whether the execution policy and/or arrangements include all sufficient steps that the investment firm could be taking to obtain the best possible result for the execution of its client orders. The execution policy may no longer be able to deliver the best possible result if the characteristics of the clientele, order type or execution venues were to change materially since the last review.

During the annual review of its execution policy, the investment services provider should seek to correct anomalies identified in the current policy and not addressed as part of monitoring the effectiveness of order execution arrangements.

The investment services provider should first determine whether its current execution policy delivers the best possible result across the universe of selected execution venues. To address this question, the investment services provider should conduct checks on the quality of execution obtained with reference to the factors included in its policy. These checks should be formally recorded by the firm and be suited to its business/clientele/size/order types. Sampling methods that take a statistical approach to ensure a representative sample might thus be considered.

²⁸ A review of a client complaint revealing non-compliance of arrangements with the execution policy does not necessarily trigger a review of the entire policy.

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The investment services provider should then assess whether it would consistently obtain the best results in terms of execution in the following cases:

- if it assigned a different relative importance to the best execution factors or if it changed any other aspect of its execution policy and/or arrangements;
- if it included different or additional execution venues or entities.

The investment services provider should consider whether adding new execution venues or assigning venues differently to different categories of financial instruments, clients or orders would improve the quality of execution.

This recommendation is not intended to steer investment services providers towards offering multiple execution choices but rather to encourage investment services providers to consider their ability to offer best execution to clients.

Illustration: assessment of other execution venues:

An investment services provider could assess whether the emergence of a new venue or increased liquidity on an execution venue that is not included in its execution policy might warrant inclusion of this venue in the policy to enhance execution quality. Firms without access to the corresponding market data under reasonable conditions may use public aggregate statistics to assess these execution venues. When considering the merits of connecting to a new venue, the investment services provider could look at the qualitative criteria described in the recommendations in paragraphs 2.1.2 and 2.1.3.

Illustration: change in the relative importance of certain factors of the execution policy: An investment services provider offering multiple execution venues to professional clients that prioritise low market impact over speed of execution could compare this factor for a given type of order on different execution venues and accordingly adjust the size of orders sent to each venue.

Position

During the annual review of its execution policy, the investment services provider shall consider potential commercial demand in favour of amendments to its execution policy. However, the lack of such demand shall not be enough by itself to rule out connecting to new execution venues or amending the execution policy. However, when deciding to modify execution arrangements or include a new execution venue in the policy, a firm may legitimately take into account the assessment of its clients' ability to properly understand the complexity of systems.

Recommendation

Where products are quoted by several counterparties selected in the execution policy, the AMF considers that an overall statistical analysis of a representative sample in terms of securities, size, etc., may be conducted to assess the best execution of orders by the selected counterparty.

Furthermore, the investment services provider could consider the possibility of contacting counterparties and entities other than those selected in its policy.

Lastly, investment services providers may use, *inter alia*, the information published under RTS 27 by the counterparties selected in their execution policy and by other execution venues for the purpose of reviewing the execution policy.

In addition to the abovementioned positions and recommendations, which apply to all financial instruments, clarifications concerning the AMF's expectations for certain specific asset classes are provided below.

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- (ii) For warrants/certificates:

Recommendation

If these products are multi-listed, an overall statistical analysis of a representative sample in terms of securities, size, etc., may be conducted to assess the best execution of orders received (comparative statistical analysis covering prices and costs borne on other markets included in the execution policy).

Furthermore, the investment services provider could consider whether to connect to other execution venues and carry out a special assessment to justify its choice either way.

- (iii) For CFDs:

Recommendation

The investment services provider should review the appropriateness of qualitative factors (such as trading hours) and quantitative factors (such as the speed with which quotes are refreshed and orders are executed, asymmetric price slippage) taken into account in its policy.

In so doing, it should not confine itself to those qualitative factors that are included in its execution policy.

The firm is responsible for determining whether it should make other changes to its execution policy and arrangements.

2.4. Investment services providers' best execution reporting requirements

2.4.1. With regard to clients

2.4.1.1. Client information on the execution policy

In accordance with Articles L. 533-12 of the Monetary and Financial Code and 44 of MiFID II DR, every investment services provider should provide its clients with clear, accurate and non-misleading information.

Regarding best execution, and in accordance with paragraph III (2) of Article L. 533-18 of the Monetary and Financial Code, investment services providers shall provide their clients with appropriate information on their order execution policy, explaining clearly, in a sufficiently detailed manner easily understandable by clients, how orders will be executed by the service providers for their clients.

Article L. (IV) of 533-18 also stipulates that "when so requested by their clients, investment services providers must be able to show that they have executed their orders in accordance with their execution policy".

Pursuant to Article 66(2) of MiFID II DR, information on the execution policy shall be "customised depending on the class of financial instrument and type of the service provided".

Pursuant to Article 66(3) of MiFID II DR, investment firms shall provide their clients, on a durable medium, with the information on their execution policy indicated in paragraph 2.1.4.).

The last paragraph of Article 66(3) of MiFID II DR specifies, in this respect, that information on the content of the execution policy shall be provided on a durable medium, or on a website (which does not constitute a durable

medium) provided that the conditions for the provision of information via a website specified in Article 3(2) of MiFID II DR are met.

Investment services providers shall also, in accordance with Article 66(4) to (9) of said regulation, provide clients with the following information:

a) Where investment firms apply different fees depending on the execution venue, the firm shall explain these differences in sufficient detail in order to allow the client to understand the advantages and the disadvantages of the choice of an execution venue.

b) Where investment firms invite clients to choose an execution venue, fair, clear and not misleading information shall be provided to prevent the client from choosing one execution venue rather than another on the sole basis of the price policy applied by the firm.

c) Investment firms shall inform clients about the inducements that the firm may receive from the execution venues. The information shall specify the fees charged by the investment firm to all counterparties involved in the transaction, and where the fees vary depending on the client, the information shall indicate the maximum fees or range of the fees that may be payable.

d) Where an investment firm charges more than one participant in a transaction, the firm shall inform its clients of the value of any monetary or non-monetary benefits received by the investment firm.

e) Where a client makes reasonable and proportionate requests for information about its policies or arrangements and how they are reviewed to an investment firm, that investment firm shall answer clearly and within a reasonable time.

f) Where an investment firm executes orders for retail clients, it shall provide those clients with a summary of the relevant 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 Articles L. 420-17, L. 533-18-2, L. 533-19 (I) and L. 533-33 of the Monetary and Financial Code, for each execution venue listed by the investment firm in its execution policy.

Lastly, in accordance with the final subparagraph of Article L. 533-18-2 of the Monetary and Financial Code, investment services providers "shall notify clients with whom they have an ongoing relationship of any material changes in their order execution arrangements or policies."

Regarding best execution in relations with retail clients, the AMF stresses the need to provide them with clear, comprehensive information, because it is on the basis of this information that clients make their decisions.

Recommendation

The examples given below are a sample of practices that the AMF has observed and that contravene the obligation to provide clients with accurate, clear, non-misleading information:

Example 1: confusing information on order placement screens

On an order placement screen, the displayed order book refers to a different market from the likely execution venue given the investment services provider's execution policy, potentially misleading the client about the execution venue.

Example 2: the investment services provider prioritises an execution venue solely because the execution fees charged by the venue are lower, concealing other material factors such as available liquidity.

A balanced description must be provided of the risks and rewards, in accordance with the requirements set out in Article 44 of MiFID II DR concerning clear and non-misleading information. Moreover, the type of communication cited in the example could encourage an investor to give specific instructions concerning the execution venue, so relieving the investment services provider of its best execution obligation towards the client in terms of the choice of execution venue.

Example 3: misleading CFD names

Some online CFD trading platforms offer products whose names may be misleading because they merely use the name of the underlying instrument.

Any communication that leads to confusion between equities and CFDs on equities should be banned. The name of the CFD should be clear and not create confusion with the underlying instrument.

Example 4: inadequate information on CFD expenses

If the expenses borne by the investor do not take the form of a commission but comprise a spread, the client is not provided with information about the size of the spread. Now, in accordance with the MiFID II provisions relating to costs and charges , information should be provided before each transaction concerning the anticipated remuneration spread. The AMF also considers that information should be provided on the benchmark used to set the spread (example: mid-point of the underlying instrument on the reference market).²⁹

Example 5: the investment services provider maintains confusion over dividend payouts in the case of a long position in a CFD on equities.

Communications of this sort are incompatible with the provisions of Article 48 of MiFID II DR. The investment services provider should clearly inform its clients that a long position in a CFD does not give entitlement to the same dividend payout as if the client owned the corresponding shares.

2.4.1.2. Obtaining the client's prior consent

In accordance with subparagraph III (2) of Article L. 533-18 of the Monetary and Financial Code, investment services providers shall obtain their clients' prior consent regarding their execution policy.

Subparagraph III (3) of Article L. 533-18 also states that when the order execution policy provides that client orders can be executed outside of a trading venue, the investment services provider shall inform its clients or potential clients of this possibility. Service providers shall obtain their clients' express consent before executing their orders outside a trading venue.

Investment services providers may obtain such consent either through a general agreement or for specific transactions.

Position

²⁹ Clarifications are given in section 9 of the ESMA Q&A on the conditions of application of this obligation.

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The AMF considers that, unlike prior consent, express prior consent entails an actual demonstration of consent by the client, which may be provided by signature in writing or an equivalent means (electronic signature), by a click on a web page or orally by telephone or in person, with appropriate record-keeping in each case.

Case of OTC bond transactions with professional clients:

The AMF acknowledges the commercial difficulties represented by this obligation for investment services providers that execute OTC bond transactions on behalf of professional clients.

Position

The AMF considers that when an investment services provider that executes orders for professional clients has included in its execution policy, in addition to a trading venue, an execution venue that is not a trading venue because this venue is among those that will enable it to obtain the best possible result in most cases, it should determine the arrangements for executing orders of this client category in the light of its professional obligations, which include the obligation “to obtain clients’ express consent before executing orders outside a trading venue”³⁰ and the obligation to act in the best interests of clients,³¹ which is a general principle that should be followed in all circumstances. If complying with this principle would lead the investment services provider to carry out an OTC transaction without being able to obtain the prior express consent of its professional client, the service provider should have made its best efforts to obtain such consent and be able to prove this.

This position applies to all investment services providers serving professional clients.

2.4.2. With regard to the public

RTS 28: classification of the top five execution venues - In accordance with Article L. 533-18-1 of the Monetary and Financial Code, investment services providers that execute client orders shall establish and publish once a year, for each category of financial instruments, the classification by trading volume of the top five execution venues on which they have executed client orders during the previous year, as well as concise information on the execution quality obtained.

Commission Delegated Regulation (EU) 2017/576 of 8 June 2016 (hereinafter "RTS 28") specifies the content and format of the information that investment services providers must publish each year concerning execution of their clients' orders. In particular, when investment services providers publish the identity of the top five execution venues in terms of trading volume, they shall specify several items of information related to the quality of execution. These items vary depending on whether the orders executed concern securities financing transactions or not. They must also publish information summarising the analysis and conclusions that they draw from detailed monitoring of the execution quality obtained on the execution venues used.

The ESMA Q&A on best execution provides clarification regarding, in particular, application of the provisions of RTS 28. In accordance with question and answer 12 of the ESMA Q&A, RTS 28 does not apply to orders executed by eligible counterparties.

RTS 27: Quality of execution - Article L. 533-18-2 of the Monetary and Financial Code stipulates in subparagraph 2 that "every investment services provider [...] recognised as an execution venue by Article 1 of Commission Delegated Regulation (EU) 2017/575 of 8 June 2016 (hereinafter "RTS 27") [...] shall make available to the public at least once a year, free of charge, data relating to the quality of execution of the transactions that were performed

³⁰ Stipulated in the second-to-last subparagraph of III of Article L. 533-18 of the Monetary and Financial Code.

³¹ Stipulated in Article L. 533-11 of the Monetary and Financial Code.

on it. These regular reports shall include detailed information on price, costs, speed and likelihood of execution for the various financial instruments.

RTS 27 specifies the content, format and frequency of the data that execution venues must publish on the quality of execution of transactions. Question and answer 12 of the ESMA Q&A specifies that all transactions, including those performed by eligible counterparties, should be included in the reports on execution quality in accordance with RTS 27.

In the same way as for RTS 28, the ESMA Q&A on best execution provides clarification regarding, in particular, application of the provisions of RTS 27.

Question 15 of the ESMA Q&A specifies, in particular, that the reporting requirements based on RTS 27 do not apply to securities financing transactions.

3. PROVISIONS RELATING TO BEST SELECTION

Pursuant to Article 65 of MiFID II DR and in order to comply with their obligation to act in the best interests of their clients, specific obligations apply to investment services providers providing the service of reception and transmission of orders, and to investment services providers providing the service of portfolio management for third parties and whose decisions to deal give rise to orders that they send to a third party for execution.

Pursuant to Article 65(4) of MiFID II DR, investment firms shall take all sufficient steps to obtain the best possible result for their clients.

Refer to section 2 of this guide for explanations concerning the concept of "sufficient steps" which is more demanding than the concept of "reasonable steps".

As a reminder, pursuant to Article 65(8) of MiFID II DR, the best selection provisions do not apply where the investment firm that provides the service of portfolio management and/or 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 investment services provider shall apply the best execution provisions applicable to service providers that provide the service of third-party order execution as described in detail in section 2 of this guide.

As stated in Recital 106 of MiFID II DR, these obligations should not require a duplication of execution efforts in those cases where an investment services provider that provides the service of reception and transmission of orders (RTO) or portfolio management transmits its orders to another service provider for execution. The aim is rather to organise a chain of cascading responsibilities.

Recommendation

As indicated in Q&A question 22, the AMF recommends that an investment services provider that transmits orders ensure that the selected entity has a best execution obligation with respect to the service provider:

- either because the entity is itself subject to best execution obligations and has agreed to treat the investment services provider as a professional or retail client;

- or because the entity has undertaken by contract to comply with any or all best execution obligations.

Thus, pursuant to Article 65 of MiFID II DR, when it transmits to a third party the orders that it has received from its clients for execution or the orders that arise from its decisions to deal, the investment services provider is required to take all sufficient steps to obtain the best possible result, taking into account the factors listed in subparagraph 1 of Article L. 533-18 of the Monetary and Financial Code (replicated in 2.1.2. of this guide) and the criteria listed in Article 64(1) of MiFID II DR (characteristics of the client, characteristics of the client order, including where the order involves a securities financing transaction, characteristics of the financial instruments, and characteristics of the entities to which that order can be directed).

3.1. Preparation of the selection policy

Article 65(5) of MiFID II DR specifies that investment services providers that provide the services of reception and transmission of orders or of portfolio management for third parties "shall establish and implement a policy that enables them to comply with the obligation [of obtaining the best possible result for their clients]".

The same article stipulates that this selection policy "shall identify, in respect of each class of instruments, the entities with which the orders are placed or to which the investment firm transmits orders for execution. The

entities identified shall have execution arrangements that enable the investment firm to comply with its obligations [...] when it places or transmits orders to that entity for execution.”

3.1.1. To what extent should the selection policy be differentiated?

In this regard, the arrangements provided for in section 2.1.1. of this guide concerning best execution are also relevant for the purposes of best selection.

3.1.2. Factors of the selection policy

In this regard, the arrangements provided for in section 2.1.2. of this guide concerning best execution are also relevant for the purposes of best selection.

3.1.3. Determining the entities to include in the selection policy

In this regard, the arrangements provided for in section 2.1.3. of this guide concerning best execution are also relevant for the purposes of best selection.

In accordance with Recital 100 of MiFID II DR, “investment firms transmitting or placing orders with other entities for execution may select a single entity for execution only where they are able to show that this allows them to obtain the best possible result for their clients on a consistent basis and where they can reasonably expect that the selected entity 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 entities for execution. The same recital specifies that “this reasonable expectation must be supported by relevant data published in accordance with” Articles L. 533-18 to L. 533-18-2 of the Monetary and Financial Code “or by internal analysis conducted by these investment firms.”

ESMA also confirmed this possibility in question and answer 3 regarding best execution (section 1 of the ESMA Q&A), including for investment services providers providing services of portfolio management or reception and transmission of orders that intend to select only a single entity in their selection policy.

3.1.4. What should a selection policy contain?

The content of the selection policy is indirectly specified by Article 65(6) of MiFID II DR concerning information to be given to the client regarding the selection policy, and refers on this subject to paragraphs 2 to 9 of Article 66 of MiFID II DR.

The selection policy should therefore contain the same information as the execution policy (see section 2.1.4 of this guide).

Recommendation

The AMF recommends that, for each class of financial instrument, the investment services provider's selection policy should:

- define the strategy, key measures taken to comply with the obligation to obtain the best possible result and how these measures enable this outcome to be achieved;**
- mention investment services providers used;**
- mention the terms under which the investment services provider may transmit specific instructions to a firm in charge of order execution, and the consequences of these specific instructions.**

In addition, the investment services provider may choose to establish a more granular classification within a particular client category if it feels it is appropriate to tailor its execution policy more closely to its clients' knowledge and experience.

Recommendation

To satisfy the client disclosure obligation, most investment services providers make their selection policy available to clients on their website. In this case, the AMF suggests to investment services providers serving retail clients that selection policies made available in this manner should refer to a link that displays a summary table listing, for each category of financial instruments typically traded by clients, the brokers used plus the execution venues used by these brokers to offer best execution. This table should be updated whenever the policy changes.

This recommendation applies to all investment services providers with retail clients.

3.2. Implementation of the selection policy

In accordance with Article 65(3) of MiFID II DR and to comply with its best selection obligation, the investment services provider shall notably take all sufficient steps to obtain the best possible result for its clients, and in particular implement the selection policy that it has established.

Therefore, compliance with the selection policy established and supervised in accordance with the provisions set out in this guide is a constituent part of compliance with the general obligation of best selection.

Note that, pursuant to Article 65(4) of MiFID II DR, an investment services provider is deemed to fulfil its obligation of best selection "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".

Regarding the transmission of orders for OTC products, pursuant to Article 64(4) of MiFID II DR, applicable to best selection in accordance with Article 65(3) of MiFID II DR, the investment services provider shall check the fairness of the price proposed to the client when transmitting an order for execution or when making a decision to deal concerning OTC products, by gathering market data used in the estimation of the price of such product and, where possible, by comparing with similar or comparable products (see also question and answer 2 of the ESMA Q&A).

3.3. Monitoring and review of the selection policy

3.3.1. Monitoring on a regular basis of the selection policy

Article 65(7) of MiFID II DR stipulates that investment services providers shall monitor on a regular basis the effectiveness of the [selection] policy and, in particular, shall monitor the execution quality of the entities identified in that policy and, where appropriate, correct any deficiencies."

Recommendation

As with the review of the execution policy and in accordance with answer 24 in the CESR Q&A, the AMF recommends that monitoring should seek to determine whether the investment services provider is complying with its policy and/or arrangements and whether the resulting transactions provide for the best possible result for the client.

The clarifications of the CESR Q&A also remain valid:

- "Monitoring may include comparing similar transactions:

(i) (...) with the same entity, in order to test whether a firm's judgement about how orders are executed is correct, or

(ii) (...) transmitted to different execution venues or entities chosen from among those in the firm's (...execution) policy, in order to test whether the 'best' execution venue or entity is being chosen for a given type of transaction";

- "that the monitoring methodology is at the discretion of the firm. Where monitoring every transaction would be disproportionate, other approaches, such as appropriate methodologies for sampling,³² may suffice.";

- "where monitoring reveals that a firm has fallen short of obtaining the best possible result, the firm should consider whether this is because the firm has failed to follow its (execution) policy and/or arrangements or because of a deficiency in such policy and/or arrangements, and make appropriate amendments".

The review shall cover:

- the investment services provider's own actions when transmitting orders to selected entities;

- the quality of execution of selected entities. In this regard, an examination of execution reports provided by investment services providers selected for execution is a necessary condition but is not sufficient to satisfy the requirements for investment services providers that transmit orders to monitor the effectiveness of their best selection policies. This examination could notably be supplemented by specific questions to investment services providers in charge of executing orders (e.g. request for details on the execution of one or more transactions).

A review of customer complaints regarding order execution could also be a way to detect errors in processes and/or parameters.

3.3.2. Review of the selection policy

Article 65(7) of MiFID II DR stipulates that investment services providers "shall review [the selection policy] and arrangements at least annually. This review shall also be performed whenever a significant change occurs that has consequences for the firm's capacity for obtaining the best possible result for its clients".

3.3.2.1. Formalisation of the selection policy review

Recommendation

The annual review of the selection policy should be formally recorded in a summary document that reports on policy amendments and the reasons for these amendments (or alternatively continued application of the current policy) as well as the arguments supporting the decision to add (or not add) new investment services providers for order execution.

On the basis of II (6°) of Article L. 533-10 of the Monetary and Financial Code, the AMF recommends that investment services providers retain the summary documents formally recording their annual review of selection policy for a period of at least five years.

3.3.2.2. Events necessitating a review of the selection policy

³² Sampling checks should be representative and tailored to the firm's business/clientele/size/order types.

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The reasons for a review of the selection policy are the same as for execution policies, with adjustments to suit the business of the investment services provider.

Article 65(7) of MiFID II DR specifies that investment services providers "shall assess whether a material change has occurred and shall consider making changes to the execution venues or entities on which they place significant reliance in meeting the overarching best execution requirement."

The same article clarifies the concept of a material change, i.e. "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".

Recommendation

The AMF recommends that, to trigger a process of review of their selection policy, investment services providers take into consideration any major change in the offer of the selected execution service providers. Significant events that could impact parameters of best execution [...] may consist, in particular, of a material change in pricing, an abrupt deterioration in execution arrangements which may be evidenced in a variety of ways, including restrictions on the scope of traded securities, discontinued access to a particular market, or restructuring with the potential to generate major operational risks in the entity to which order execution has been entrusted.

Recommendation

It is recommended that investment services providers transmitting orders to a third party when providing an RTO or portfolio management service for a third party ensure that the contractual relationship with service providers selected for order execution includes a clause requiring notification in the event of amendments to the execution policy.

3.3.2.3. Due diligence to be conducted when reviewing the selection policy

Recommendation

Consistent with answer 25.2 in the Q&A, the AMF recommends that investment services providers that transmit or place orders with other entities for execution take different approaches [from that of paragraph 25.1]³³ to their review and monitoring requirements, depending on how much control they exercise over the way their orders are executed.

It is certainly the case that the approaches taken may differ depending on how much control investment services providers exercise over the way orders are executed. A service provider that merely sends orders for execution will rely to a high degree on the executing entity.

Alternatively, a service provider that sends an order with instructions about how the order is to be executed "should monitor and review its own actions and their impact on the execution quality it is obtaining".

Example: an investment services provider acting as RTO entity that receives an order to sell 50,000 securities and decides to split it into five orders of 10,000 securities for five different brokers should determine whether each broker has obtained best execution for the order to sell 10,000 securities rather than conduct an overall review of the execution terms for its order to sell 50,000 securities. The firm should also consider how appropriately it split up the order.

³³ *Investment services providers that execute orders or decisions to deal should review and monitor the measures that they take to obtain the best possible result, as well as the performances of the execution venues that they use.*

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Recommendation

In accordance with answer 25.4 in the CESR Q&A, the AMF recommends that an investment services provider that transmits orders should, during its review, consider the quality of execution actually provided by the entities to which it has entrusted the execution of client orders.

An investment services provider with the authorisation or status required to transmit orders and execute orders by itself should also compare the results obtained from these entities with those that it would obtain by executing the orders itself. Moreover, it should examine the possibility of using other entities or of executing transactions itself provided that this is permitted under its authorisations.

3.4. Investment services providers' best selection reporting requirements

3.4.1. With regard to clients

3.4.1.1. Client information on the selection policy

Pursuant to Article 65(6) of MiFID II DR, investment services providers shall provide their clients with information on the selection policy that they have determined. The information to be provided in this respect is the same as that to be provided concerning the execution policy (see section 2.4.1 above). Investment services providers shall also provide their clients with appropriate information concerning themselves and their services, as well as the entities chosen for execution purposes.

In accordance with the last subparagraph of the same article, the investment services provider shall provide its clients or potential clients who reasonably request it with information on the entities with which orders are placed or to which the service provider transmits orders for execution.

In accordance with Article 65(6) of MiFID II DR, and with reference to the last subparagraph of Article 66(3) of said regulation, the selection policy shall be provided on a durable medium, or on a website (which does not constitute a durable medium) provided that the conditions of Article 3(2) of MiFID II DR are met.

In accordance with the last subparagraph of Article L. 533-18-2 of the Monetary and Financial Code, investment services providers shall notify clients with whom they have an ongoing relationship of any material changes in their order execution arrangements or policies.

3.4.1.2. Obtaining the client's prior consent

Unlike investment services providers that execute orders, there is not, in the regulations, any obligation to obtain clients' prior consent for service providers that transmit or place orders with other entities for execution when those orders are executed outside a trading venue. Accordingly, literal application of the regulations would lead the very great majority of end clients to not be informed beforehand of the conditions of execution of their orders.

For example, if an investor sends an order to an entity providing RTO services ("RTO entity"), which routes the order to an investment services provider for execution, there is no requirement for the RTO entity to obtain the end client's consent to the execution policy of the ISP executing the order. The regulations provide in this case that it is the RTO entity, in its capacity as a client, that consents to the execution policy of the entity executing the order³⁴. The RTO entity should in turn draw up a selection policy that should be submitted to its own clients, without needing to obtain their consent.

³⁴ Provided that the RTO is categorised as a client by the executing entity and not as an eligible counterparty.

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The AMF therefore reiterates that, in accordance with Article 65(6) of MiFID II DR, with reference to e) of Article 66(3), the selection policy shall contain an indication of the fact that the executing service provider may execute client orders outside a trading venue, and the consequences this entails, such as counterparty risk arising from execution outside a trading venue, and, at the client's request, additional information about the consequences of this means of execution.

3.4.2. With regard to the public

Pursuant to Article 65(6) of MiFID II DR, "when the [investment services provider] selects other [investment services providers] to provide order execution services, it shall summarise and make public, on an annual basis, for each class of financial instruments, the top five investment firms in terms of trading volumes where it transmitted or placed client orders for execution in the preceding year and information on the quality of execution obtained. The information shall be consistent with the information published in accordance with RTS 28."

4. LINK BETWEEN RESEARCH AND SELECTION

Commission Delegated Directive 2017/593 of 7 April 2016 now lays down rules regarding the purchase of research services which requires investment services providers to have policies for the selection, evaluation, invoicing and payment of research services that are completely decorrelated from existing execution policies.

As a consequence, the selection of an execution broker can in no way be dictated by considerations relating to the conditions of that broker's provision of a research service.

In this respect, as a reminder, paragraphs 3 to 5 of Article 314-29 of the AMF GR stipulate that "Where the investment services provider provides execution services, it shall identify separate charges for these services that only reflect the cost of executing the transaction.

Charges relating to the provision of any other benefit or service by an investment services provider to another investment services provider established in a State party to the European Economic Area agreement shall be separately identified.

The supply of benefits or services and charges for those benefits or services shall not be influenced or conditioned by levels of payment for execution services."

However, it is not forbidden to use the same investment services provider for the supply of the two services, execution on the one hand and research on the other hand, provided that it can be demonstrated that the selection of this investment services provider corresponds both to:

- best selection obligations, and in particular those applicable to the selection of investment services providers as clarified in paragraph 3.1.3 of this guide, and

- the obligations clarified in paragraph 7.4 of the AMF Guide to the conditions of funding of research by investment services providers in accordance with the MiFID II directive in the following terms: "the firm shall take into account the potential risks of conflicts of interest in its research policy, and shall check that the internal procedures ensure an effective decorrelation between research costs and transactions."

5. PRACTICES INVOLVING PAYMENT FOR ORDER FLOWS

In some situations, the best execution obligation has to be combined with other professional obligations placed on investment services providers, such as those pertaining to inducements and remuneration and the identification and management of conflicts of interest.

This is notably the case for several practices entailing the granting of monetary or non-monetary benefits by some execution venues to their clients/members in exchange for order flows. These benefits may take the following forms in particular:

- non-public price reductions;
- provision of tools or payment of connection fees; or
- allocation of bonus shares.

In particular, Article 66(6) of MiFID II DR stipulates that investment services providers "shall only receive third-party payments if these payments comply with the provisions on inducements and remuneration and shall inform clients about the inducements that the firm may receive from the execution venues".

To be considered legitimate, third-party payments should therefore be analysed in light of articles L. 533-12-4 of the Monetary and Financial Code and 314-13 et seq. of the AMF General Regulation, which lay down three cumulative criteria: transparency with regard to clients, improvement in the quality of service rendered and respect for the client's interest³⁵.

As regards the criterion of improvement of the quality of service provided for the client, it is now defined in Article 314-14 of the AMF GR which requires compliance with three conditions combined:

1. Be "justified by the provision of an additional or higher level service to the relevant client, proportional to the level of inducements received, such as:
[...]
 - o the provision of access, at a competitive price, to a wide range of financial instruments that are likely to meet the needs of the client, including an appropriate number of instruments from third-party manufacturers having no close links with the service provider, together with:
 - o either the provision of added-value tools, such as objective information tools helping the relevant client to take investment decisions or enabling the relevant client to monitor, model and adjust the range of financial instruments in which they have invested; or
 - o the provision of periodic reports on the performance and costs and charges associated with the financial instruments;"
2. Not "directly benefit the recipient service provider, its shareholders or employees without tangible benefit to the relevant client;"
3. Be "justified by the provision of an ongoing benefit to the relevant client in relation to an ongoing inducement."

Therefore, payment for order flow practices should now be examined in light of these three conditions combined.

³⁵ *Except for minor non-monetary benefits.*

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