MiFID II’s “go live” date of 3 January 2018 is often thought of as a “big bang.” However, the new EU directive is less a one-off fireworks display and more like a series of fairly intense bushfires over the next year, for firms. Best execution, which comes with a series of rolling obligations and deadlines, is one area that will keep the trading desks, operations departments, compliance teams and Best Execution committees on-call.

Below are 10 key challenges that firms should focus on when it comes to MiFID II Best Execution compliance in the months ahead:

1. **Gathering the data for the first RTS 28 report** – This is the most immediate concern for many firms – it is due, although recognised by ESMA that this is on a “best endeavours basis,” by 30 April 2018. Investment firms must publish their top five destinations for order flow, across all asset classes they are active in. Further classifications are required beyond this, too. Including whether the transaction was retail or institutional, and whether a firm performed the role of executor, or receiver and transmitter, for an order. For smaller firms, this data challenge may be much simpler than it will be for larger, more complex firms with multiple trading systems.

2. **Publishing the RTS 28 data on your website** – All of this data needs to be published on the investment firm’s website in prescribed tables, and in a machine-readable format. It’s unwise to leave this until the last minute – posting materials on corporate websites can take time and require collaboration with the marketing team, legal, IT, and other site stakeholders. If the firm is using an outside vendor to host the RTS 28 reports, the link from the corporate website must be directly to the reports themselves, not to a more general area of the vendor’s website.

3. **Analyzing your own RTS 28 data and respond** – Although investment firms are required to publish this data only once a year, MiFID II makes it clear that regulators expect firms to be actively reviewing this dataset much more regularly. And not just the top five, but all of the data. Firms need to establish who will have responsibility for performing this analysis internally – for example, the front office, operations, or compliance. Organizations should consider the data from both a business and a risk perspective. For example, some financial instrument classes may show a high level of counterparty concentration – should the firm alter its approach? The firm’s best execution committee then needs to review these reports, and ensure that these reviews are minuted.

4. **Analyzing your competitor’s data and respond** – Most investment firms will have a list of firms they consider to be direct competitors. Someone within the organization should be tasked with downloading the reports of these competitors and analyzing them for who their top five are – are there volume or counterparty outliers? The right stakeholders should then set time aside to consider the firm’s relationships in light of this information. For example, is the firm using the most competitive venues, and if not, why? – and be prepared to justify significant differences to the regulator.
5. **Preparing the RTS 28 qualitative reporting** – While the RTS quantitative reporting can be performed to a “best endeavours” standard this year, regulators will be expecting a level of completion for the qualitative reporting requirements. Firms should also not expect this qualitative reporting to remain static. The regulators expect firms to update parts of this disclosure as the firm’s best execution policies and on-the-ground activities evolve. Investment firms should also think carefully about the language they use in this qualitative reporting, depending on whether their client base is primarily institutional or retail.

6. **Taking another look at trading arrangements with perks** – The qualitative disclosure part of RTS 28 requires firms to describe arrangements with execution venues that involve discounts, rebates, or other non-monetary benefits. Firms need to evaluate any arrangements they may have either directly, or indirectly – such as broker smart order routing, where algorithms may be based on rebates. Organizations need to have robust due diligence processes in place for broker selection, and decide in advance how risks or conflicts with trades should be handled. It goes without saying that this must all be documented and permissible under the new FCA inducements rules.

7. **Reviewing cases where price or liquidity were not factors** – RTS 28’s qualitative reporting also demands disclosure of the criteria used to execute a client trade if other factors took precedence over cost or liquidity. Firms need to put in place processes that enable traders to justify the basis on which a trade is performed – either on all trades or on trades that fall outside specific benchmark parameters. Compliance and the front office need to jointly decide on which benchmarks are appropriate, and the benchmarks used by the firm should be a topic of ongoing conversation at the best execution committee. All of these individual decisions need to be documented in such a way that they can be justified to the regulator.

8. **Getting ready for RTS 27** – On a quarterly basis from June, execution venues – including market makers, systematic internalizers, exchanges, MTFs and OTFs – will have to publish significant quantities of data about the quality of their trade executions. This data is intended to help investment firms decide which venues are the most competitive to trade on. In practice, firms are going to have to put in place solutions to digest this tsunami of execution quality data, and then use it to help inform where they decide to place their trades. While this seems like best practice, it’s also a MiFID II requirement under RTS 28 – in Q1 2019, this must be reported on.

9. **Acquiring a solution for managing MiFID II best execution data** – It’s clear that many firms might choose technology to assist with Best Execution reporting. However, the type of solution the firm will need can vary widely depending on the size and complexity of the firm’s operations, as well as the products it trades. Small firms may be able to get by with performing the analysis needed on a (very large) spreadsheet. However, medium-sized or larger firms of any complexity would have been wise to consider industrializing the Best Execution reporting process as much as and as soon as possible. Regulatory technology solutions (or RegTech as it is often called) are already in the market, and are being launched all the time to help firms meet these demands. It’s important, however, that organizations understand their needs and how a solution will meet them, before purchase.

10. **Aligning best execution policies with reality** – Firms should have had their updated best execution policies in place for the 3 January 2018 deadline. However, these policies are, in practice, only the first statement of MiFID II best execution compliance. As firms move through 2018 and into 2019, regulators will expect to see these policies evolve in light of “what really happens” in investment firms, and in response to the new data that will become available over the course of the year. Naturally, supervisors wish to see all changes thoroughly documented. As well, firms should be prepared to fully evidence their risks and controls map – how processes are completed in practice, and how they are tested. Best Execution committees should be sure to set time aside specifically to explore questions around policy and controls, as well as regulatory disclosure around these.
MiFID II Best Execution is far from complete – regulators have a wide range of fresh expectations from firms over the coming 12 months. Compliance teams should ensure they are engaged in active discussions across the organization so that trading desks, operations, IT, and the Best Execution committees can fulfil these onerous obligations. Leaving Best Execution reporting to the last minute could expose the firm to significant compliance and reputational risk.

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Jon leads our project assignments covering independent compliance conduct and prudential assurance, CASS client money and assets, UCITS, ICAAP and operational risk and compliance infrastructure reviews. He led Cordium’s service development for MiFID II and AIFMD and regularly leads Cordium regulatory seminars and our annual regulatory forum.

Jon has over 20 years’ financial services experience, having qualified with Coopers and Lybrand, then moving on to positions with UK regulator, UBS, Deutsche and Merrill Lynch Investment Managers. He is a Chartered Accountant with a politics degree from Warwick University.

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Kim is a senior Project Consultant working with a range of investment firms on a wide range of compliance projects. Kim has 13 years’ financial services experience, having formerly worked as a senior compliance manager at Gartmore, which specialised in hedge fund, institutional and retail strategies. Her regulatory experience covers risk management processes, financial crime and market abuse, conduct of business obligations, client assets, training and competence standards, collective investment schemes and prudential standards monitoring.

She has a BA Hons in Law from Sussex University and has also achieved the Investment Management Certificate (IMC), the most widely recognised qualification of its kind in the UK demonstrating regulatory competence.