Best Execution

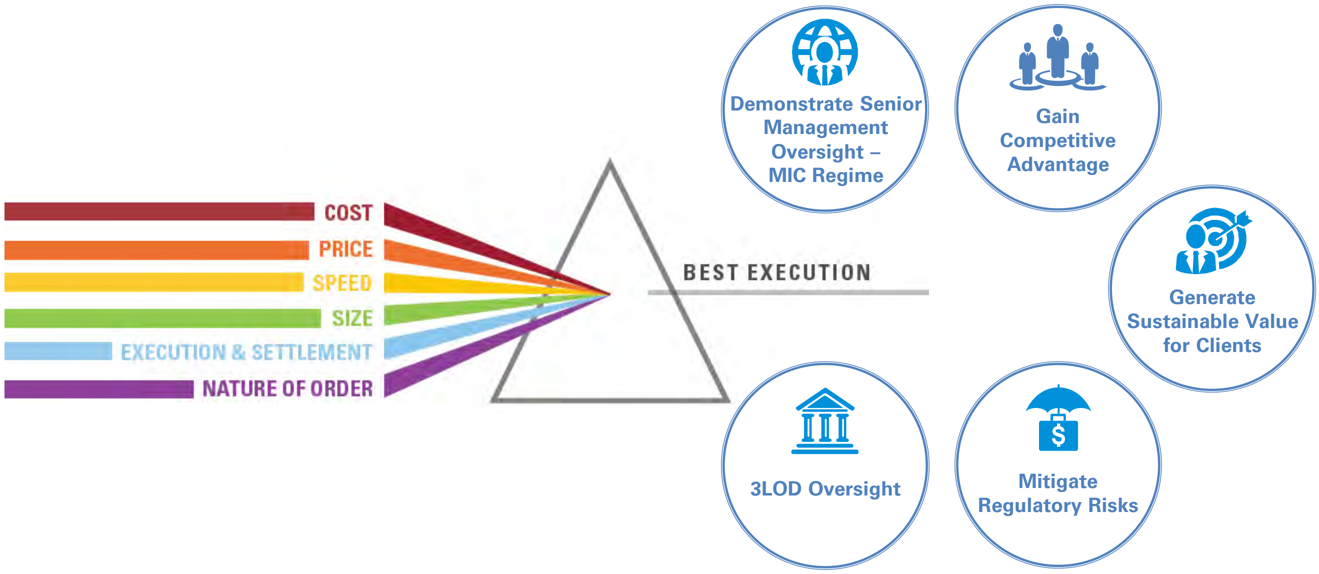
It's not just about price

February 2018

On January 30 2018, the Securities and Futures Commission released a circular on **Best Execution**. The circular outlines the **Commission's expected Best Execution standards** for all Licensed Corporations to observe and provides **in-depth guidance** on **specific areas of focus**, including **governance & management supervision**, **monitoring and controls**. This brings Hong Kong regulation into closer alignment with those of other jurisdictions, including MiFID II.

Best Execution requires executing client orders on the **best available terms**. It impacts any financial institution that handles client orders, including wealth management and asset management firms as well as firms of all size from local brokers to global financial institutions and institutional buy side firms. Given the complexity of financial products and services offered in today's market, a **broad set of execution factors must be considered**.

The Importance of Best Execution



Common Challenges with Best Execution

Potential challenges for firms to comply to Best Execution requirements

Adequacy of Systems and Controls	Data Challenges	Demonstrability	Client Documentation	Broker Selection and Monitoring
• How adequate are your processes and methodologies to monitor Best Execution compliance?	• Does your firm have access to the required data inputs for effective TCA reporting?	• Do you have a framework to demonstrate Best Execution across all types of instruments?	• How clear are your policies, terms and conditions and other disclosures made to your clients about Best Execution?	• How robust is your selection process for counterparties? What about for those in different regulatory jurisdictions?
• Do Compliance and Risk departments have the tools they need to effectively monitor and challenge the Front Office?	• How have you tackled issues such as affiliate trades?	• Can you consistently demonstrate Best Execution to your clients or the regulator 'on demand'?	• Do they aid or hinder the client's understanding of your approach to Best Execution?	• Do you have on-going monitoring to ensure your clients are receiving Best Execution via these parties?

KPMG's view on a Best Execution Framework

- **Sufficient management oversight** for **timely** review of issues/exceptions.
- **Committees** with appropriate **stakeholder representation**.
- **Mandates** across **asset classes** and **scenarios**.
- **Management Information** to facilitate **monitoring** of Best Execution delivery.

- **Obligation of Best Execution** to client **remains with the LC**, regardless of whether execution is passed to another party.
- **Due diligence** should be **performed** on the execution arrangements of affiliates, connected parties and third parties.
- **Continuous monitoring** of affiliate & other party execution outcomes.

- **Determination** of which BE **criteria** are **relevant** for **all** instruments and products, then take **sufficient** steps to obtain **best available terms**, based on those criteria.
- **Clear policy** on the **applicability** of Best Execution, **specific instructions** and **carve-outs**.
- **Front Office awareness** of the level of **Due Diligence required** to deliver Best Execution.

- **Compliance** and **Risk** understand the risks and can **actively challenge** processes and controls.
- **Appropriate metrics** and **benchmarks** based on **characteristics** of instruments, **complexity** and **scale** of operations.
- Regular **thematic reviews and testing** across regions / venues / brokers and assets.

Best Execution Maturity Model

Below Regulatory Expectations	Below the Market	In line with the Market	Leading in some areas	Consistently leading in the Market
• Firm exclusively focuses on business objectives; ignores customer outcomes • Risk and control functions are wilfully disempowered • Lack of rigorous reviews or challenge of policies and procedures • Wilfully ineffective trade monitoring through ineffective systems • No internal accountability	• Firm overly-focussed on business objectives; insufficient focus on customer outcomes • Risk and control functions are not empowered to challenge front office or management • Policies and procedures are not rigorously challenged • Ineffective trade monitoring through limited sample sizes and legacy IT • Lack of internal accountability	• Firm focuses on business objectives; customer outcomes are secondary • Policies and procedures are reviewed periodically, but insufficiently challenged • Risk and control responsibility is owned by Compliance • Trade monitoring generates insufficient / ineffective alerts • Internal accountability is siloed through a committee structure	• Firm balances focus between business objectives and customer outcomes • Policies and procedures are reviewed annually and challenged • Risk and control responsibility is collectively shared • Trade monitoring is broadly effective and produces MI used to manage BE obligations • Internal accountability is clearly articulated and effective	• Firm's business objective is delivering good customer outcomes • Policies and procedures are benchmarked against best practice • Firm culture requires staff to contribute to risk identification and control • Automated trade monitoring produces real-time MI can demonstrate BE is achieved • Execution arrangements are demonstrably market-leading

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