

Final Report

Technical Standards specifying the criteria for establishing and assessing the effectiveness of investment firms' order execution policies



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1 Executive Summary

Reasons for publication

The Directive amending the Directive on Markets in financial instruments (MiFID II Review Directive)¹ was published in the Official Journal of the European Union (EU) on 8 March 2024. The European Securities and Markets Authority (ESMA) has been required to develop draft regulatory technical standards (RTS) specifying the criteria for establishing and assessing the effectiveness of investment firms' order execution policies, accounting for whether the orders are executed on behalf of retail or professional clients.

On 16 July 2024, ESMA published a Consultation Paper to seek stakeholders' views on ESMA's proposals for this RTS. The consultation period closed on 16 October 2024. ESMA received 43 responses, 4 of which were confidential. The answers received are available on ESMA's website² unless respondents requested otherwise.

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Section 2 sets out the background. This includes the legal background, policy background, assessment, context, and Feedback Statement relating to the draft technical standards related to investment firms' order execution policies which were included in the aforementioned ESMA public consultation.

Section 3 consists of two Annexes. Annex I contains the costs-benefit analysis undertaken in relation to the draft technical standards. Annex II contains the draft technical standards.

Next Steps

The draft regulatory technical standards are submitted to the European Commission for adoption. In accordance with Article 10 of Regulation (EU) 1095/2010, the European Commission shall decide whether to adopt the technical standards within three months.

¹ Directive (EU) 2024/790 of the European Parliament and of the Council of 28 February 2024 amending Directive 2014/65/EU on markets in financial instruments, OJ L, 2024/790, 8.3.2024, p. 1-11.

² See: <https://www.esma.europa.eu/press-news/consultations/consultation-technical-standards-specifying-criteria-establishing-and>

2 Background

1. On 25 November 2021, the European Commission adopted a legislative proposal for a Directive³ amending the Directive on Markets in financial instruments (“MiFID II”⁴).
2. The final amending Directive (“MiFID II Review Directive”) was published in the Official Journal on 8 March 2024 and entered into force on 29 March 2024.⁵
3. Article 1(4)(e) of the MiFID II Review Directive requires ESMA to develop a RTS on the criteria for establishing and assessing the effectiveness of investment firms’ order execution policies.

2.1 Legal background

New paragraph 27(10) of MiFID II (as set out by Article 1(4)(e) of the MiFID II Review Directive)

ESMA shall develop draft regulatory technical standards to specify the criteria to be taken into account in establishing and assessing the effectiveness of the order execution policy pursuant to paragraphs 5 and 7, taking into account whether the orders are executed on behalf of retail or professional clients.

Those criteria shall include at least the following:

- (a) factors determining the choice of execution venues included in the order execution policy;*
- (b) the frequency of assessing and updating the order execution policy;*
- (c) the manner in which to identify classes of financial instruments as referred to in paragraph 5.*

ESMA shall submit those draft regulatory technical standards to the Commission by 29 December 2024.

³ Available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0726>

⁴ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, (OJ L 173, 12.6.2014, p. 349–496).

⁵ Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202400790

Power is delegated to the Commission to supplement this Directive by adopting the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1095/2010.’;

4. Article 27 of MIFID II sets out best execution requirements which aim at ensuring that investment firms take all sufficient steps to obtain, when executing client orders, the ‘best possible result’ for their clients.
5. More specifically, Article 27(1) of MiFID II stipulates that Member States must require that investment firms take all sufficient steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. Nevertheless, where there is a specific instruction from the client the investment firm is obliged to execute the order following the specific instruction.
6. Moreover, where an investment firm executes an order on behalf of a retail client, the best possible result must be determined in terms of the total consideration, representing the price of the financial instrument and the costs relating to execution, which must include all expenses incurred by the client which are directly relating to the execution of the order, including execution venue fees, clearing and settlement fees and any other fees paid to third parties involved in the execution of the order.
7. Additionally, for the purposes of delivering the best possible result in accordance with the above-mentioned requirement, where there is more than one competing venue to execute an order for a financial instrument, the investment firm’s own commissions and the costs for executing the order on each of the eligible execution venues shall be taken into account in that assessment.
8. Article 27(4) of MiFID II sets out that Member States must require investment firms to establish and implement effective arrangements for complying with the obligation set out by Article 27(1) of MiFID II. In particular, Member States shall require investment firms to establish and implement an order execution policy to allow them to obtain, for their client orders, the best possible result.
9. Article 27(5) of MiFID II specifies that the order execution policy must include, in respect of each class of financial instruments, information on the different venues where the investment firm executes its client orders and the factors affecting the choice of execution venue. It must at least include those venues that enable the investment firm to obtain on a consistent basis the best possible result for the execution of client orders.
10. Additionally, Member States shall require that investment firms provide appropriate information to their clients on their order execution policy. That information shall explain

clearly, in sufficient detail and in a way that can be easily understood by clients, how orders will be executed by the investment firm for the client. Member States shall require that investment firms obtain the prior consent of their clients to the order execution policy.

11. Member States shall also require that, where the order execution policy provides for the possibility that client orders may be executed outside a trading venue, the investment firm shall in particular inform its clients about that possibility. Investment firms shall obtain the prior express consent of their clients before proceeding to execute their orders outside a trading venue. Investment firms may obtain such consent either in the form of a general agreement or in respect of individual transactions.
12. Article 27(7) of MiFID II stipulates that Member States shall require investment firms which execute client orders to monitor the effectiveness of their order execution arrangements and execution policy for the purpose of identifying and, where appropriate, correcting any deficiencies. In particular, investment firms shall assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best possible result for the client or whether they need to make changes to their execution arrangements. Investment firms are required to notify clients with whom they have an ongoing client relationship of any material changes to their order execution arrangements or execution policy.
13. Article 27(8) of MiFID II sets out that Member States shall require investment firms to be able to demonstrate to their clients, at their request, that they have executed their orders in accordance with the investment firm's execution policy and to demonstrate to the national competent authority, at its request, their compliance with this Article.

2.2 Policy background assessment and context of the draft RTS

14. When an investment firm executes a specific client order, the choice of the appropriate execution venue requires a complex assessment of a range of factors (inter alia, the offered price of the related financial instrument, liquidity provided on the venue, and transaction costs charged by venues for the order). Therefore, the selection of an appropriate execution venue is a crucial task for the firm to achieve the best possible result in the execution of its client orders, i.e., to obtain "best execution". The complexity of this choice is further increased as the securities market of the European Union is highly fragmented.⁶ This usually results in a broad choice of venues where a firm can send an order to buy or sell a financial instrument.

⁶ As of April 2024, the EU securities market encompassed, for example, 309 trading venues and 181 systematic internalisers (see [ESMA Registers \(europa.eu\)](https://www.esma.europa.eu/press-material/press-conferences-and-events/press-conferences-and-events/esma-registers)).

15. To ensure that firms take all sufficient steps to obtain the best possible result when executing their clients' orders (while accounting for inter alia price, costs, speed of execution), Article 27 of MiFID II sets out requirements for firms concerning best execution. This includes the obligation for firms to describe their processes to achieve best execution, so called "order execution policies", and to implement these policies.
16. However, as observed during ESMA's work related to the MiFID II best execution requirements and more profoundly by NCAs through their supervisory activities, shortcomings and areas for improvement exist in the actual implementation of firms' execution policies under MiFID II. In other words, it has been observed that in some EU jurisdictions some firms, inter alia: did not provide sufficiently documented analyses to justify their choice of execution venues; did not properly demonstrate that they executed client orders in accordance with their order execution policies, if adequately established in the first place; and disclosed publicly only rather generic information about their order execution policy and their steps taken to obtain the best possible result when executing client orders.
17. Additionally, feedback from national competent authorities and stakeholders expressed during the legislative procedure related to the MiFID II Review Directive, has indicated that requirements for firms' order execution policies could also benefit from further clarification.
18. Thus, ESMA has developed the draft RTS in accordance with the mandate set out in Article 27(10) of MiFID II. From the policy perspective order execution policies should effectively enhance the execution quality for retail and professional clients, through requirements aiming at fostering an effective establishment and assessment of the order execution policy. These obligations encompass inter alia criteria for the selection of execution venues allowing to effectively obtain best execution and for a robust assessment resulting in appropriate updates of firms' execution policies and order execution arrangements when necessary.

Context of the draft RTS

19. The draft RTS was developed against the backdrop of the Level 1 and 2 requirements of the MiFID II framework and the specific features and practices of the markets in firms' execution of client orders. In the following, the rationale for the proposals included in the draft RTS (included in Annex II) is detailed, in the broader context of the other applicable Level 1 and 2 requirements.
20. It should be noted that, where investment firms authorised to execute orders on behalf of clients and/or to deal on own account and/or to receive and transmit orders, bring about or enter into transactions with eligible counterparties, the firms are not legally obliged to comply with the obligations under Article 27 of Directive 2014/65/EU.

21. Retail clients legitimately rely on the firm to protect their interests in relation to the pricing and other parameters of the transaction. However, professional clients may not always rely on the investment firm for best execution in the same way. Whether or not a professional client may rely on the investment firm for best execution depends on the specific circumstances and should be assessed on an individual basis. This assessment should account for at least the specific agreement between the investment firm and the professional client, the characteristics of the financial instrument involved, the ability for the professional client to observe market transparency, and the ability to obtain competitive quotes from other firms.
22. Both senior management and the compliance function have an important role within the investment firm to ensure its compliance with its obligations under the MiFID II framework. Due to the complex nature of best execution and the importance of the topic, these functions may rely on support by other units of the investment firm, for example, the risk management unit, to ensure decisions are made on a sound basis. However, both the compliance function and senior management should be involved in the establishment and assessment of the order execution policy, and the latter should have an actual decision-making role.
23. Moreover, it is important that investment firms keep appropriate records of their client relations, client order handling and any order execution policies, arrangements, and reviews thereof, in a machine-readable format to enable competent authorities to fulfil their supervisory tasks and perform enforcement actions efficiently, as needed, to ensure both investor protection and market integrity.
24. Where investment firms rely on a third party by means of outsourcing, those firms are also subject to the requirements of the MiFID II framework relating to outsourcing, inter alia Section 2 of the Commission Delegated Regulation (EU) 2017/565.

2.3 Feedback Statement

Q1: Do you agree with the proposed categorisation of classes of financial instruments? And could the methodology based on, inter alia, the classification of financial instruments in the MiFID II RTSs 1 and 2 be used in the context of MiFID II transparency reporting be an alternative? Please state the reasons for your answers.

25. A majority of respondents expressed concerns with the categorisation of classes of financial instruments based on the Classification of Financial Instruments (CFI) methodology. They stated that this would lead to many classes, some mentioned over 70 potential classes of financial instruments which would mean a high administrative burden. Moreover, these respondents noted that the criterion of the country of primary listing would further increase that burden. In contrast, some respondents did support the CFI

methodology and highlighted inter alia that the CFI methodology allowed for better and more granular analyses. A majority of respondents noted that the amount of information on the classes of financial instruments might be difficult to understand for clients due to the proposed granularity. Some respondents also referred to the deletion of RTS 27 and RTS 28 by the MiFID II Review Directive and stated that the introduction of new disclosure requirements would go against the rationale behind that deletion.

26. Additionally, some other respondents supported the alternative approach, stating that it provides greater flexibility. Finally, some respondents did not provide a preference between the proposed and alternative approaches. Some respondents mentioned an additional alternative categorisation of classes of financial instruments based on the classification which had been established under RTS 28. They stated that firms are already using such methodology in practice, and it is sufficient for best execution analysis.
27. ESMA would like to clarify that the categorisation of classes of financial instruments is for internal purposes only and not intended to be disclosed to clients, see also ESMA's response on feedback to question 8 in paragraph 64.
28. ESMA takes note of the concerns expressed by respondents on the granularity of classes of financial instruments. At the same time, ESMA considers it important that firms identify classes of financial instruments with sufficient granularity, to ensure that the execution quality can be assessed for homogenous groups of products. This aims at ensuring that firms obtain the best possible results for clients for each of the respective classes of financial instruments. Grouping heterogenous products into one class would introduce the risk that potential unfavourable execution quality for certain products within such a cluster remains undetected.
29. In light of stakeholders' feedback, ESMA opted for an alternative approach, inspired by the model of the classes of financial instruments included in RTS 28 and already used by firms, to simplify the approach initially proposed and leave more room for discretion to firms. Accordingly, ESMA identified nine classes of financial instruments and a tenth residual class. In addition, firms are expected to identify subclasses within these classes of financial instruments under the following two conditions. Firstly, if within one pre-defined class of financial instruments a firm applies several execution methodologies (i.e., each for a subset of products within that class) to a significant number of orders, it is crucial that the firm considers whether this requires identifying additional subclasses of financial instruments. Or secondly, if the firm's analysis reveals that the identification of subclasses enables a better and more effective assessment of the firm's obtained execution quality, the firm should consider the need to identify additional sub-classes.

Q2: Do you believe that the current wording of the RTS is clear and sufficient with regard to the content of the order execution policy where an investment firm selects only one

execution venue to execute all client orders? Or should the RTS provide for specific criteria to be taken into account when assessing if the selected venue achieves the best possible result in the execution of client orders? Please also state the reasons for your answer.

30. A majority of respondents noted that the wording proposed in the draft RTS of the consultation paper is clear and sufficient with regard to the content of the order execution policy where an investment firm selects only one execution venue to execute all client orders. Some of these respondents pointed out that no further criteria should be included in the draft RTS for the assessment whether the selected venue achieves the best possible result in the execution of client orders.

31. However, some respondents, including a consumer association, stated that the requirements of the draft RTS in the consultation paper in relation to investment firms' selection of only one execution venue to execute all client orders is not sufficient. These respondents also made proposals to further specify the provisions for firms using only one execution venue, which encompassed inter alia:

- firms' execution policies should always include more than one execution venue or the use of only one execution venue should lead to additional attention in the application of best execution requirements, such as more frequent monitoring and assessments of the firm's obtained execution quality;
- firms' selection of a single venue should be limited to specific contexts (e.g. where only one venue offers a specific product; or where one venue has a significantly high liquidity related to specific instruments) and should be made conditional on: (i) any exclusive agreement between a firm and a venue being disclosed in the firm's best execution policy to ensure transparency; (ii) the firm being obliged to disclose a comparison of the actual execution costs of the single venue to the costs accrued on a comparable alternative venue.

32. Additionally, a few respondents were of the view that the current MiFID II provisions for firms selecting only one execution venue for their order execution would be sufficient and that no such provision should be included in the draft RTS.

33. ESMA has observed that the possible use of one venue for client order execution is an existing market practice adopted by some firms. It is important to ensure that a firm with such order execution arrangements takes all sufficient steps to obtain the best possible result when executing client orders. Thus, ESMA has in contrast to its proposal of the Consultation Paper addressed this issue more specifically in the draft RTS' requirements for the initial selection of execution venues for the order execution policy. Accordingly, a firm selecting only one venue to execute client orders (for a given class of financial

instruments or all client orders) is obliged to set out in its order execution policy how this selected single venue ensures obtaining the best possible result for clients (Article 3(3) and Recital 2 of the draft RTS). The draft RTS also requires a firm to control in its assessment of the effectiveness of the order execution policy whether the chosen single execution venue obtains consistently the best possible result for clients (Article 8(3) of the draft RTS).

Q3: Do you agree with the proposed factor of “order sizes” respectively for retail and professional clients, to be considered in investment firms’ selection of eligible execution venues in their order execution policy and internal execution arrangements (see Article 4(1)(d)(i and ii) of the draft RTS)? If not, what alternative factor would you propose?

34. Most respondents disagreed with the proposed factor of order sizes. They stated that the requirement to account for at least two different order sizes for both retail and professional clients is overly prescriptive. They also noted that specifically for professional clients this has limited added value, as professional clients and their order sizes are very diverse. Some respondents also noted that this seems more relevant for cash equity markets and less for other types of products.
35. Some respondents also noted that it is unclear whether Article 4 of the draft RTS in the consultation paper only applies to firms establishing an order execution policy for the first time (i.e., when they commence business in the EU), or that it also applies to firms who established their order execution policies before the application date of the RTS.
36. When an investment firm establishes its order execution policy for the first time, ESMA considers it important that the firm takes into consideration the characteristics and needs of the clients to which it intends to provide execution services.
37. Therefore, the firm should be aware of certain specificities, such as the typical order sizes they are expecting from future clients. Only the knowledge of such specificities, enables the firm to select the execution venues, where it reasonably expects to obtain on a consistent basis the best possible result for its clients.
38. ESMA notes that the absolute number of a minimum of two different order sizes for both retail and professional clients can be seen as strict. Therefore, ESMA proposes more proportionally and discretion for firms to analyse themselves how many different order sizes are necessary (if necessary, at all). ESMA has changed the requirement in Article 3 accordingly.
39. ESMA considers that the requirements for the selection of execution venues for the order execution policy (Article 3) apply to (i) firms which establish a new order execution policy, or (ii) firms with an already established order execution policies, if the results of their

monitoring and assessment of their order execution policies' effectiveness (Articles 7 and 8) show that that modifications in the firm's choice of execution venues are necessary to achieve the best possible result for their clients. Additionally, firms selecting only one execution venue to execute client orders for a given class of financial instruments are required to set out in their order execution policies, how the one selected execution venue ensures obtaining the best possible result for their clients.

Q4: Do you agree with ESMA's proposals for the specification of the criteria for establishing and assessing the effectiveness of investment firms' order execution policies? Please also state the reasons for your answer.

40. Some respondents, including a consumer association, generally approved the proposals for establishing and assessing the effectiveness of investment firms' order execution policies. They did state that some proportionality and/or clarifications should be added. In contrast, a majority of respondents did not. Several reasons were stated, including:

- A majority of respondents expressed the view that the requirements concerning the establishment and assessment are too detailed and prescriptive, leading to unnecessary administrative burden.
- Some respondents mentioned that the reference to real time and/or historic market data in Article 5 should be deleted. Some respondents noted that this would lead to an order-by-order check on the price, which is not intended by MiFID II and also not proportionate.
- Some respondents stated that the reference to the consolidated tape date is too strong and would introduce a de facto mandatory consumption of consolidated tape data, which they stated is not in line with MiFID II.
- Some respondents mentioned that the period of three months to correct any deficiencies identified in the assessment, as required by Article 7, is too short as connecting to new execution venues and IT changes might take longer.
- Some respondents stated that role of the compliance function and senior management, as described in Recital 16 of the consulted draft RTS, contradicts with the general responsibility of the compliance function as the compliance function should not have a decision-making role.

41. ESMA takes note of the feedback received from stakeholders. ESMA is of the view that the requirements related to the establishment and assessment of order execution policies provide for necessary safeguards for a consistent application of the best execution requirements and are not too prescriptive or administratively burdensome in general.

42. However, in ESMA's view investor protection can be ensured by introducing additional proportionality in certain requirements of the draft RTS, including:

- In Article 4, ESMA clarified that the market data referred to in paragraph 3, point (e), only has to be taken into account where it is available and deemed relevant by the investment firm. Thus, a firm is for instance not required to consider real time and/or historical market data for each order, but only when this information is available and deemed relevant for the specific order by the firm. For instance, for more liquid financial instruments historical data might not be relevant to identify an appropriate venue to rout a client order for execution. In contrast, for a large trade in an illiquid instrument, historical prices and potential historical settlement issues might be relevant criteria on whether to rout an order to a certain venue (or not). Therefore, ESMA is of the view that is important that firms consider what criteria are important when defining their order routing process.
- In Article 7, the reference to a specific frequency, such as the three months included in the consulted draft RTS in relation to the monitoring, has been deleted in the monitoring of the Final Report. ESMA considers that for different firms, different periodicities could be sufficient. Therefore, it is up to the firm to take into account its size and the complexity of its activities and to justify what monitoring periodicity corresponds with such profile.

43. ESMA takes note of the feedback on the role of the compliance function and shares the view that the reference to a decision-making role should not be applicable to the compliance function. This point is amended accordingly (see paragraph 22 of this Report).

Q5: Do you agree with ESMA's proposal that investment firms may rely on monitoring and assessments performed by third parties, such as independent data providers, as long as firms assess the processes of these third parties? Please also state the reasons for your answer.

44. Most respondents agreed with ESMA's proposal that firms can rely on monitoring and assessments performed by third parties, such as independent data providers, if firms assess the processes of such parties.

45. Additionally, some of these respondents noted that their agreement was based on current market practices, inter alia, that:

- the established outsourcing processes ensure the provision of, for instance, services related to the monitoring and assessment of firms' execution quality, inter alia based on transaction cost analysis;

- such third-party services may benefit smaller firms, which due to their limited resources might otherwise have problems in setting up their own monitoring and assessment capacities.

46. Furthermore, a few of the respondents, including a consumer association, articulated their agreement, while also highlighting potential risks which can emerge, if third parties are in charge of monitoring and assessing firms' order execution policy. For instance, conflicts of interests may arise, if the third party providing the monitoring or assessment service is not independent from the firm offering the order execution services. These respondents also highlighted the importance of the firm being finally responsible that the monitoring and assessment services provided by third parties do comply with the relevant requirements of the draft RTS and the MiFID II framework.

47. In ESMA's view, it is important to highlight that firms are required to review thoroughly the monitoring of the execution policy performed by third parties (Article 6(6) of the consulted draft RTS). Moreover, firms must ensure that analyses of an execution policy assessment performed by the third party are representative of the firm's client base, with regards to the financial instruments and order sizes assessed (Article 7(7) of the consulted draft RTS). While important, ESMA opted not to include these provisions in the draft RTS in this Final Report, as firms are already subject to the requirements of the MiFID II framework relating to outsourcing, inter alia, Section 2 of the Commission Delegated Regulation (EU) 2017/565.

Q6: Concerning the specific client instruction, should it be possible for an investment firm to pre-select an execution venue in the order screen, where the firm invites its clients to choose an executing venue out of multiple options? And if so, do you agree that only if the client chooses a different venue than the one pre-selected by the firm, the choice of execution venue does constitute a specific instruction? Please also state the reasons for your answer.

48. The majority of respondents agreed that it should be possible for investment firms to pre-select an execution venue when inviting a client to choose an execution venue. They also agreed that when the client does not change this pre-selected execution venue, it does not constitute a specific client instruction. Only when the client selects a different venue than the one pre-selected, it should constitute a client instruction. One respondent expressed the view that even when the client goes through with the pre-selected execution venue, it constitutes a client instruction.

49. In contrast, some respondents expressed concerns with the possibility of pre-selecting execution venues by firms. They noted that it could undermine the purpose of the best execution requirements. In addition, few respondents expressed the view that pre-selecting an execution venue should not be allowed at all.

50. Some respondents expressed concerns with the warning to the client immediately prior to placing an order included in the proposed Article 8(4)(c) of the draft RTS in the consultation paper. In the view of these respondents, the warning would delay the ordering process of clients, which is not in their best interest. Some of those respondents also noted that the information on the order execution policy provided to clients should already include a similar warning in accordance with Article 66(3)(f) of Commission Delegated Regulation (EU) 2017/565.
51. Lastly, some respondents expressed the view that the possibility for clients not to specify an execution venue, as proposed in proposed Article 8(4)(d) of the draft RTS in the consultation paper, should be deleted.
52. ESMA appreciates the feedback from stakeholders on the possibility to pre-select an execution venue when inviting a client to choose an execution venue. In light of the feedback from some respondents who expressed concerns with the possibility to pre-select venues, ESMA would like to stress that when an execution venue is pre-selected and not changed by the client, this does not constitute a specific instruction in accordance with Article 27(1) of MiFID in relation to the venue selection. Consequently, the best execution obligations fully apply and the responsibility for the choice of the venue entirely lies with the firm.
53. Regarding the warning to the client immediately before placing an order, ESMA notes that it depends on the specific implementation at firms whether this would cause a delay in the ordering process. Nonetheless, ESMA acknowledges that the information on the order execution policy provided to clients already contains a similar warning, where relevant. Therefore, ESMA deleted the requirement for the warning prior to placing an order in the draft RTS.
54. With regards to the possibility not to specify an execution venue, ESMA considers that it is primarily the responsibility of the firm to obtain the best possible result for its clients. Clients might be in a situation where they are not willing or don't have the possibility to make an informed decision on which execution venue they might obtain the best execution quality. Therefore, clients should have the possibility of not specifying an execution venue and leave it the responsibility of the firm to execute the order in accordance with its order execution policy.

Q7: Where an investment firm executes client orders by dealing on own account (including back-to-back trading), in light of the specificity of this execution model and since it is bound by the rules governing best execution, do you believe the current text is clear with regard to what kind of obligations investment firms applying such model should comply with? Or do you believe it would be useful to provide in the RTS list and explanations of information that should be included in the order execution policy, such

as related to the method and steps to be taken by the firm to establish the price of client transactions in back-to-back trading, or the methodology for the firm's application of mark-ups or mark-downs in such order executions? Please also state the reasons for your answer.

55. Most respondents noted that the text included in the draft RTS is sufficiently clear on the obligations for firms executing client orders on own account, including back-to-back trading. Additionally, a few of these respondents proposed to integrate the relevant current requirements of the MiFID II framework into the draft RTS.
56. However, in the view of a few respondents, including a consumer association, specific requirements of the draft RTS would need to be further specified. These respondents mainly proposed to further specify firms' disclosure requirements of what type of methodology for mark-up or mark-downs is applied in own account client order execution (average and instrument-specific). This proposal aims at better disclosing how the mark-ups and mark-downs are calculated and their impact on the costs of the client's trade.
57. Furthermore, a few respondents suggested modifying the scope of the requirements for firms' order execution on own account proposed in the draft RTS. The proposals of these respondents included to delete the following requirement from the consulted draft RTS: Article 9(3) stipulating that when dealing on own account in OTC products according to Article 64(4) of Commission Delegated Regulation (EU) 2017/565, firms must set out in their order execution policy how the fairness of the price proposed to the client is ensured. This would aim at avoiding unnecessary administrative burden for firms. Moreover, in the view of two respondents, Article 9(3) of the consulted draft RTS does not only refer to OTC products, but to all types of dealing on own account transactions. Therefore, it is proposed to modify this wording to clarify that Article 9(3) of the consulted draft RTS only refers to order execution on own account of OTC products.
58. To clarify the requirements for firms executing client orders by dealing on own account, ESMA has amended several points of this draft RTS in comparison to the provisions proposed in the consultation paper. Firstly, as reaction to stakeholders' replies, ESMA has amended the requirement for a firm to set out in its execution policy how it ensures the fairness of the price when executing client orders in OTC products. This aims at aligning this provision with the wording of Article 64(4) of Commission Delegated Regulation (EU) 2017/565 (Article 6 of the RTS). Secondly, to ensure firms achieve the best possible result when executing client orders through dealing on their own account, ESMA specifies certain requirements in the draft RTS. Firms must outline in their order execution policy how they ensure a fair price for financial instruments executed through dealing on their own account. Where available, firms should take into account the price of the financial instrument observed in the market. Where this price is not available, the price of a similar, comparable or underlying financial instrument should be used. In cases where such price is also not

available, the price⁷ must be determined through an internal pricing model. This internal pricing model must be based on reliable and truthful data that reflects market conditions.

59. Lastly, ESMA highlights that in accordance with Article 30(1) MiFID II, firms executing client orders through dealing on own account with an eligible counterparty, are outside the scope of the MiFID II best execution requirements and thus also outside of the scope of this draft RTS.

Q8: Are there any additional comments that you would like to raise and/or information that you would like to provide (for example, relevant information in relation to any expected costs and benefits arising from the proposals)?

60. The majority of respondents expressed concerns with the burden that may result from the draft RTS. Some respondents mentioned that this would specifically affect smaller firms, and asked whether proportionality could be introduced in certain provisions.

61. The majority of respondents also noted that the RTS would have the effect that order execution policies will be longer, adding to the information overload that is already experienced by clients. Some respondents also mentioned that the rules should not apply when firms are only forwarding orders.

62. Some respondents expressed concerns that the drafting of the reference to the consolidated tape data would introduce a de facto mandatory consumption of consolidated tape data. In the view of these respondents, this would not be in line with the MiFID II Level 1 text.

63. Given that the implementation of the RTS is time consuming, some respondents noted that an implementation period of 12 to 18 months should be foreseen.

64. ESMA would like to clarify that the draft RTS sets out requirements for the internal order execution policy and processes. It does not set out provisions for disclosures to clients. In contrast, Article 66 of Commission Delegated Regulation (EU) 2017/565 sets out what information on the order execution policy firms shall provide to clients, and ESMA does not intend to suggest any change to Article 66 as a result of this RTS. In practice, modifications of the internal order execution policy (for instance a change in the execution venues used by the firm to execute client orders) may result in changes of the information on the order execution policy disclosed to clients.

65. In addition, the draft RTS only applies for the service of the execution of orders. The only exception is where the firm offers both the services of reception and transmission of orders

⁷ Including any mark-ups and mark-downs applied by the firm,

and execution of orders for the same class of financial instruments. In such cases only Article 2(4) of the draft RTS applies. Accordingly, a firm shall specify in its order execution policy how it complies with the obligation to act in the best interests of its clients in accordance with Article 24(1) of Directive 2014/65/EU when deciding whether or not to execute the order itself.

66. In general, ESMA does not share the concerns expressed about the burden introduced by the draft RTS. The draft RTS as consulted already included several provisions to provide flexibility for firms, for instance that they may rely on third parties for the monitoring and assessment of the effectiveness of the order execution policies.
67. However, following the feedback received, ESMA has re-assessed the consulted draft RTS and as a result has made additional proposals to provide more discretion and proportionality for firms. As explained in paragraph 29, ESMA opted for an alternative approach for the classification of financial instruments. This results in a significant decrease in the number of classes. Additionally, ESMA deleted the requirement for firms to take into account at least two different order sizes for both retail and professional clients, which was set out in Article 4(1)(d)(i and ii) of the draft RTS in the consultation paper.
68. With regard to the consolidated tape data, ESMA considers that the consolidated tape providers can provide for the high-quality data required for the reference datasets. However, it is not the intention of the draft RTS to introduce a de facto mandatory consumption of the consolidated tape data. Firms are free to source the data they deem useful for the purposes of best execution, if it provides a reliable and truthful presentation, in terms of completeness and accuracy of the data, of the execution prices obtained in the market. Therefore, ESMA has redrafted those provisions, to prevent that the references to the consolidated tape data could be interpreted as a mandatory consumption of such data.
69. ESMA notes that the draft RTS in the consultation paper did not include a proposed implementation period. ESMA agrees that firms should have sufficient time to implement updated order execution policies. Therefore, the draft RTS includes a proposed application date 18 months after entry into force of the RTS.

3 Annexes

3.1 Annex I – Cost-benefit analysis

Impact of the draft RTS under Article 27(10) of MiFID II

1. As per Article 10(1) of Regulation (EU) No 1095/2010, any draft regulatory technical standards developed by ESMA shall be accompanied by an analysis of ‘the potential related costs and benefits’ of the technical standards.
2. MiFID II sets out obligations for investment firms to execute orders on terms most favourable to the client. These include the requirement for firms to establish and implement an order execution policy, including the information set out in Article 27(5) of MiFID II, to allow them to obtain the best possible result in the execution of orders on behalf of their clients. Additionally, firms are required to monitor the effectiveness of their order execution arrangements and execution policies to identify and, where appropriate, correct any deficiencies, in accordance with Article 27(7) of MiFID II.
3. The next paragraphs present the cost-benefit analysis of the main policy options included in this Final Report on the criteria for establishing and assessing the effectiveness of investment firms’ order execution policies under Article 27 of MiFID II.

Problem identification

4. Order execution policies help firms to allow them to obtain the best possible result for their clients in accordance with Article 27(1) of MiFID II. It provides valuable information to relevant employees of the firm on the safeguards implemented, how to handle client orders, and it facilitates a consistent approach in order execution for all clients throughout the firm.
5. In addition, the order execution policy of a firm may be requested by a national competent authority to supervise the firm’s compliance with the MiFID II best execution obligations. Therefore, this policy must include complete, meaningful and robust information to enable the national competent authority to assess whether (or not) the firm has established and implemented an order execution policy to allow to obtain, for its client orders, the best possible result in accordance with Article 27(1) of MiFID II.
6. Lack of sufficient detail of information on the firm’s steps taken to establish and assess the effectiveness of its policy for the execution of client orders may hamper the proper order execution for clients and the ability of the national competent authority to appropriately supervise the firms’ compliance with the MiFID II best execution requirements.

7. Additionally, the absence of harmonised information in firms' order execution policies on how they establish them and assess these policies' effectiveness to obtain the best possible result for the client, may lead to diverging approaches to order execution policies and different practices of implementing them across firms and Member States. This could hinder the level playing field and lead to a significantly diverging quality in the execution of client orders (e.g. with regards to price and costs) across EU firms and Member States. Against this background, MiFID II mandates ESMA to develop a RTS to specify the criteria to be taken into account when establishing and assessing the effectiveness of firms' order execution policies.

Policy objectives

8. The objective of the draft RTS is to provide clarity and to harmonise the requirements related to the criteria which firms are obliged to take into account when they establish and assess their order execution policies. More specifically, the draft RTS aims at specifying the requirements to ensure that firms' order execution policies and the related order execution arrangements are effective and allow the firm to achieve the best possible result in the execution of client orders. This also aims at enabling firms to clearly demonstrate to national competent authorities their compliance with the relevant MiFID II best execution requirements.
9. From a broader perspective, the draft RTS also aims at enhancing the execution quality for clients and thereby to contribute to ensuring appropriate investor protection under MiFID II.

Baseline scenario

10. The baseline scenario is the situation where firms executing orders on behalf of clients comply with their obligations related to order execution policies under Article 27 of MiFID II and the Commission Delegated Regulation (EU) 2017/565 without any further specification of these requirements by any draft RTS. Thus, if a national competent authority supervised a firm's compliance with the MiFID II requirements related to the effectiveness of its order execution policies, the national competent authority would request information based on the requirements set out in Article 27(4), (5) and (7) of MiFID II and Article 66 of the Commission Delegated Regulation (EU) 2017/565.
11. As these requirements have a rather general nature, this may have a twofold significant impact. Firstly, the information contained in firms' order execution policies may be of a rather high-level character and lack appropriate detail. For example, related to information on how firms ensure an appropriate monitoring of the effectiveness of their order execution arrangements and policies. This may not enable national competent authorities to effectively assess whether the firm has established and implemented an order execution

policy to obtain, for its client orders, the best possible result in accordance with Article 27(1) of MiFID II. Secondly, such rather general requirements can lead to a divergent application by firms, and by competent authorities, of the relevant MiFID II requirements. This may affect the firms' requirements to monitor the effectiveness of their order execution arrangements and execution policies and to assess regularly whether the venues included in the execution policies allow the firm to obtain the best possible result for the client, or whether any changes to these policies and arrangements are required. Consequently, this can hamper the quality of firms' client order execution, for instance with regards to price and costs, at the detriment of investors. This can also lead to uncertainties on the application of the requirements and divergences across Member States, or even among firms in the same jurisdiction.

Options considered and preferred options

12. This section presents the main policy options discussed and the decisions made when developing the draft RTS. The policy options' respective advantages and disadvantages and the preferred options resulting from this analysis are assessed below.

Policy issue 1: How to identify classes of financial instruments

13. ESMA considered three policy options:

- Option 1a: A methodology based on ISO Standard 10962 on the Classification of Financial Instruments (CFI), with additional classes for equities based on the country of primary listing.
- Option 1b: A methodology with a list of 15-20 classes set out in the draft RTS, inspired by the classification of financial instruments set out by MiFID II RTS 1 and 2⁸, with additional classes for equities based on the country of primary listing.
- Option 1c: A methodology with a list of 10 classes set out in the draft RTS inspired by the classification of financial instruments of the MiFID II RTS 28⁹, with potentially

⁸ Commission Delegated Regulation (EU) 2017/587 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser (RTS 1): <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0587> Commission Delegated Regulation (EU) 2017/583 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives (RTS 2): <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0583>

⁹ Commission Delegated Regulation (EU) 2017/576 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution (RTS 28): <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R0576>

additional subclasses, where necessary, according to the specific circumstances of individual firms.

14. ESMA considers it important that firms identify classes of financial instruments with sufficient granularity, to ensure that the execution quality can be assessed for homogenous groups of products. Therefore, ESMA adopted Option 1a in the Consultation Paper. This aimed at ensuring that firms obtain the best possible results for clients for each of the respective classes of financial instruments. In contrast, grouping heterogenous products into one class would introduce the risk that potential unfavourable execution quality for certain products within such a cluster remains undetected.
15. However, ESMA takes note of the concerns expressed by respondents to the consultation on the granularity of classes of financial instruments and the potential accompanying administrative burden. Therefore, ESMA considers it appropriate to opt for a more proportionate approach to identify classes of financial instruments that would result in a significant decrease in the number of classes to identify. In the CP, ESMA already included Option 1b as a potential alternative with considerably less classes of financial instruments to identify. However, while supported by some respondents, the number of classes could still increase significantly due to the additional classes for equities based on the country of primary listing.
16. Therefore, ESMA developed an alternative methodology that includes a limited number of classes of financial instruments, without the need to identify additional classes for equities based on the country of primary listing. Accordingly, firms would be required to assess whether it is necessary to identify subclasses based on their specific circumstances, not by default. This more proportionate approach strikes a balance between identifying homogeneous groups of products and the efforts necessary from firms. So, Option 1c, requires firms to identify only ten common classes of financial instruments, one of which is a residual class, and which is less than in the MiFID II former RTS 28 by which this option is inspired and less detailed than the proposals initially made in the CP.
17. Thus, Option 1c was chosen as the preferred option.

Policy issue 2: Level of detail of the criteria for firms' monitoring of the effectiveness of the execution quality and the order execution arrangements

18. ESMA considered two policy options:
 - Option 2a: Set out high-level criteria in the draft RTS for the monitoring of the effectiveness of the execution quality and execution arrangements.

- Option 2b: Specify the criteria in the draft RTS for the monitoring of the effectiveness of execution quality and execution arrangements.
19. To ensure that a firm obtains the best possible result in the execution of client orders, it is important that the firm monitors its execution quality and execution arrangements. Accordingly, the firm monitors continuously whether its arrangements of client order execution based on the selected venues complies with its order execution policy and obtains the best possible result for the client in accordance with Article 27(1) of MiFID II. This includes that the monitoring enables the firm to identify any deficiencies hampering the effectiveness of its order execution arrangements. However, if the criteria for the monitoring of the execution quality and order execution arrangements are set out in the draft RTS as high-level provisions without appropriate specification (Option 2a), the monitoring might be performed insufficiently and the national competent authority may not be able to properly assess, whether the firm has established an appropriate monitoring procedure and/or order execution arrangements to comply with its order execution policy and achieve the best possible result for its clients.
20. To ensure that firms implement a robust policy concerning the monitoring, and to allow a national competent authority to assess meaningfully the effectiveness of a firm's monitoring of its order execution arrangements and order execution policy, the order execution policy should not only contain high-level criteria on the monitoring. Instead, the policy should also include criteria in appropriate detail on which a firm bases its system (inter alia the reference data with which the firm compares its obtained execution prices and the threshold the firm applies to monitor its execution quality).
21. Thus, Option 2b was chosen as the preferred option.

Policy issue 3: Level of detail of the criteria for firms' periodic assessment of the effectiveness of the order execution policy

22. ESMA considered two policy options:

- Option 3a: Set out high-level criteria in the draft RTS for the periodic assessment of the effectiveness of the order execution policy.
 - Option 3b: Specify the criteria in the draft RTS for the periodic assessment of the effectiveness of the order execution policy.
23. An additional crucial requirement for a firm to obtain the best possible result in the execution of client orders is the periodic assessment of its order execution policy's effectiveness. To this end, the firm uses the results of its monitoring to assess regularly whether its order execution arrangements and policy effectively obtain the best possible

results for its clients. This also requires the firm to modify its order execution arrangements and execution policy, if inter alia, the assessment concludes the firm's current execution arrangements would not obtain the best possible result for clients. However, if the requirements for the criteria for the periodic assessment of the effectiveness of the order execution policy are set out in the draft RTS as high-level provisions without appropriate specification (Option 3a), the assessment might be performed insufficiently and the national competent authority may not be able to properly assess whether the firm has sufficiently assessed the effectiveness of its order execution policy and has corrected any deficiencies (where needed).

24. To ensure that firms implement a robust policy concerning the periodic assessments and to enable a national competent authority to assess meaningfully the effectiveness of a firm's order execution policy (including its order execution arrangements), the order execution policy should not only contain high-level criteria on the firm's periodic assessment procedure. In contrast, the policy should also include criteria in appropriate detail on the factors which a firm applies in its periodic assessment (for example, how the firm accounts for the emergence of new execution venues; including new functionalities and fee structures).

25. Thus, Option 3b was chosen as the preferred option.

Cost-benefit analysis

26. The draft RTS on the criteria for establishing and assessing the effectiveness of investment firms' order execution policies is expected to result in both costs and benefits to firms, national competent authorities, and benefits to clients.

Costs

27. Firms will incur one-off costs related to the update of their order execution policies which may result from the more specific requirements set out by the draft RTS, and the analysis thereof. As the draft RTS provides an application period of 18 months, this one-off exercise might be combined with an already planned review of firms' order execution policies. While many firms will already use a combination of qualitative and quantitative methods for the purposes of best execution, some firms might utilise no or limited quantitative elements. The latter might face additional IT implementation costs.

28. Firms will also incur ongoing costs mainly for the monitoring and assessment of the order execution policies and order execution arrangements. However, ESMA expects that most of these costs already currently derive from the relevant requirements of Article 27 MiFID II and the Commission Delegated Regulation (EU) 2017/565, with more limited additional costs stemming from the implementation of the draft RTS.

29. For national competent authorities, the costs relate to the resources required for the supervision of the relevant MiFID II best execution requirements. Clients and execution venues will not incur any direct costs stemming from the draft RTS.

Benefits

30. In terms of benefits, the draft RTS will foster firms' consistent application of the MIFID II requirements related to establishing and assessing the effectiveness of firms' order execution policies and order execution arrangements, thereby levelling the playing field and promoting a fair competition between firms on execution quality. Additionally, such an increase in consistency in the application of the relevant rules under the MIFID II framework can reduce the reputational risk for firms.

31. National competent authorities will benefit from the draft RTS through harmonised application of the requirements. This should result in firms' provision of more meaningful and robust information on the establishment and assessment of the effectiveness of their order execution policies and order execution arrangements to the authorities. This allows the national competent authorities to effectively assess in a less time- and resource-intensive way, whether a firm has established and implemented an order execution policy to allow to obtain the best possible result in the execution of its client orders (or not).

32. Clients will benefit, as the requirements of the draft RTS may result in an increased quality in the execution of their orders, for instance relating to price and costs of execution.

33. Finally, better insights of firms in their order execution quality might result in them connecting to other or additional execution venues. This may result in new potential for execution venues to provide their services to firms.

Table: Costs and benefits of the draft RTS on the order execution policies of investment firms

Stakeholder groups affected	Costs	Benefits
Investment firms	Initial one-off costs related to the update of firms' order execution policies and the implementation of potential changes to their order execution arrangements and IT systems.	Consistent application of the MIFID II requirements related to establishing and assessing the effectiveness of firms' order execution policies and order execution arrangements can level the playing field and promote a competition on execution quality between firms.

Stakeholder groups affected	Costs	Benefits
	Ongoing costs of ensuring compliance with the requirements set out in the draft RTS.	Less reputational risk.
National competent authorities	Ongoing cost of supervision of the relevant best execution requirements under the MiFID II framework.	<p>Harmonisation and increased consistency of the requirements related to the execution of client orders under the MiFID II framework.</p> <p>More meaningful and robust information enabling the national competent authorities to assess in a less time- and resource-intensive way, whether (or not) the firm has established and implemented an order execution policy to allow to obtain, for its client orders, the best possible result in accordance with Article 27(1) of MiFID II</p>
Clients of investment firms	-	Increased quality in the execution of client orders (e.g. relating to price and costs).
Execution venues	-	Potentially new investment firms connecting to and using the services offered by execution venues.

3.2 Annex II - Draft RTS specifying the criteria for establishing and assessing the effectiveness of investment firms' order execution policies

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supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the criteria to be taken into account in establishing and assessing the effectiveness of order execution policies of investment firms

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU¹⁰, and in particular Article 27(10), fourth subparagraph thereof,

Whereas:

- (1) Whereas Commission Delegated Regulation (EU) 2017/565¹¹ sets out the information on the order execution policy that investment firms should provide to their clients, this Regulation sets out requirements for the order execution policy, which is an internal document.
- (2) To ensure the selection of execution venues consistently enables investment firms to achieve the best possible result when executing client orders, investment firms should apply their internal governance procedures on execution venue selection and keep an up-to-date list of internally approved execution venues. For the same reason, investment firms selecting only one execution venue to execute client orders for a given class of financial instruments, or for all client orders, should set out in their order execution policies how selecting one execution venue ensures obtaining the best

¹⁰ OJ L 173, 12.6.2014, p. 349.

¹¹ Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 87, 31.3.2017, p. 1).

possible result. Investment firms should account for the costs of connecting to execution venues when selecting the venues for its order execution policy to the extent that such costs would be passed on to clients directly or indirectly.

- (3) Investment firms need high-quality reference datasets to be able to monitor their execution policies and arrangements. They should use this information captured on a continuous basis to feed into periodical assessments as to how effectively their order execution policies deliver sufficient execution quality. The reference datasets firms use should provide a reliable and accurate presentation of the execution prices in the market, such as the data provided by consolidated tape providers, where available. This information will also allow investment firms to periodically assess the effectiveness of these policies. Alternative external data sources can also be used where they provide a reliable and accurate position. Investment firms should make sure that the reference datasets they use contain at least data from the most liquid execution venues for the instruments traded within each class of financial instruments.
- (4) Where a specific client order can be executed on several venues, the execution policy should include information on the obligatory and discretionary factors the investment firm considered when making the order routing decision. Investment firms should not use an automatic order routing system if the firm is aware prior to the execution of an order that using such a system may have an adverse impact on the execution quality.
- (5) Where clients provide a specific instruction related to a part or aspect of an order, the investment firm should follow this instruction in respect of that part or aspect when executing the order. All other parts and aspects of the order that are not part of the specific instruction should be treated as a regular client order. Article 64(2) of Commission Delegated Regulation (EU) 2017/565 sets out that when following such a specific instruction, the investment firm satisfies its obligation under Article 27(1) of Directive 2014/65/EU to take all sufficient steps to obtain the best possible result for a client. The specific instruction has significant investor protection consequences, as it might impact the execution quality. It is important that when establishing their order execution policies, firms clarify in this policy what constitutes a specific client instruction, the potential impact on the execution factors and execution quality and the safeguards in place to ensure the correct implementation of the specific client instruction. These safeguards should, among others, prevent the firms from applying practices such as dark patterns, that materially distort or impair, either intentionally or effectively, or that hamper the ability of recipients of the service to make autonomous and informed choices or decisions.
- (6) An investment firm should establish an effective order execution policy which obtains the best possible result for its clients in accordance with Article 27(1) of Directive 2014/65/EU when executing client orders based on own account deals, such as on a matched principal bases (back-to-back trading) or dealing against the firm's own proprietary position. Therefore, its order execution policy should address the appropriate steps of the firm to identify, prevent and manage conflicts of interest between the firm and clients in accordance with Article 23 of Directive 2014/65/EU and Articles 33 and 34 of Commission Delegated Regulation (EU) 2017/565.

- (7) Where an investment firm has initiated the offering of investment services as regards the execution venues it has selected and identified for its order execution policy, the investment firm should monitor its order execution arrangements and order execution policy. The investment firm should monitor the execution quality of the orders it has executed for its clients and define thresholds per class of financial instrument to be able to continuously monitor, whether it obtains the best possible result for clients on a consistent basis. For these thresholds, firms should define the proportion of transactions that should be executed at a similar or better price than the prices included in the reference dataset. The monitoring of these thresholds should include proportional targets and set an acceptable deviation while ensuring execution quality. Firms should also account for any relevant impact in the deviation based on differences in execution costs, between the venue where the order is executed and the venues of the reference dataset. This monitoring should encompass price, costs and other relevant execution factors to enable the firm to initiate an event-driven review of its order execution policies and arrangements and the selection of execution venues in case the achieved execution quality is insufficient.
- (8) The investment firm should periodically assess the effectiveness of its order execution policy by evaluating the selected execution venues and established order execution arrangements. This may lead to the conclusion that an execution venue no longer consistently obtains the best possible result. This periodic assessment should be performed at least annually, but where the monitoring identifies that thresholds are infringed, this can also trigger an immediate *ad hoc* assessment of the order execution policy's effectiveness. For instance, where a firm selected one execution venue to execute all orders for a given class of instruments, or all client orders, and the results of the firm's monitoring showed that significantly more transactions than allowed have been of low execution quality, this would breach the predetermined thresholds. Consequently, an immediate assessment of the effectiveness of the order execution arrangements and order execution policy would be required.
- (9) The investment firm's periodic assessment of the effectiveness of its order execution policy should include an assessment to ensure that contractual arrangements, such as long-term contracts or exclusivity agreements, do not impede the objective of providing the best possible result for the client, in particular, when deficiencies have been identified and need to be corrected.
- (10) The identification of classes of financial instruments on a granular level for internal purposes is important to ensure that the execution quality can be assessed for homogenous groups of products. This ensures that firms obtain the best possible results for clients for each of the respective classes of financial instruments. Grouping heterogenous products into one class might introduce the risk that potential unfavourable execution quality for certain products within such a cluster remains undetected.

- (11) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.
- (12) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council¹²,

HAS ADOPTED THIS REGULATION:

Article 1
Definitions

For the purposes of this Regulation, the following definitions shall apply:

- (1) 'execution venue' means an execution venue as referred to in Article 64(1), second subparagraph, of Commission Delegated Regulation (EU) 2017/565;
- (2) 'classes of financial instruments' means the classes and subclasses of financial instruments identified by investment firms in accordance with Article 9 of this Regulation.

Article 2

General criteria to be taken into account in establishing an order execution policy

1. Investment firms shall specify the following in their order execution policies:
 - (a) the internal governance procedures for the selection of execution venues;
 - (b) the measures taken to ensure selected execution venues are authorised by competent authorities or, in case the execution venue is in a third country, if applicable, the third-country authority.
2. Investment firms shall maintain an internal list of the execution venues selected as part of their order execution policies, which shall include the following information in respect of each execution venue:
 - (a) the name and identifier of the execution venue;
 - (b) the date when the investment firm approved the execution venue for its order

¹² Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

- execution policy;
- (c) the name and capacity of the person or governance body of the investment firm that approved the selection of the execution venue;
 - (d) the classes of financial instruments for which the execution venue may be used;
 - (e) the types of transactions for which the execution venue may be used, including securities financing transactions as defined in Article 3(11) of Regulation (EU) 2015/2365 of the European Parliament and of the Council¹³;
 - (f) whether the execution venue may be used for retail or professional clients;
 - (g) any other limitations of the execution venue.
3. Investment firms shall specify in their order execution policies the arrangements and valuation systems, including a list of data providers used for that valuation, to ensure systematic and robust checks of the fairness of the price for orders executed on behalf of clients in classes of financial instruments that are executed over the counter, including bespoke products, in accordance with Article 64(4) of Commission Delegated Regulation (EU) 2017/565.
4. Where an investment firm offers both the investment services of execution of orders on behalf of clients, and reception and transmission of orders, the investment firm shall specify in its order execution policy how it complies with the obligation to act in the best interests of its clients in accordance with Article 24(1) of Directive 2014/65/EU when deciding whether or not to execute the order itself.

Article 3

Selection of execution venues for the order execution policy

1. Investment firms shall take into account the characteristics and needs of the clients to which they provide investment services when selecting execution venues for their order execution policy, including:
- (a) the factors referred to in Article 27(1) of Directive 2014/65/EU;
 - (b) the availability of certain order types;
 - (c) for the criterion of size, the typical or relevant order sizes of its clients and the typical or relevant frequencies of orders;

¹³ Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (OJ L 337, 23.12.2015, p. 1).

- (d) for the criterion of costs, the following fees and costs charged to the investment firm:
 - (i) trading and order execution fees;
 - (ii) cost of membership to execution venues or connectivity to them;
 - (iii) costs and charges for clearing, settlement, custody and other administration services related to the choice of execution venue;
 - (e) for the criterion of price, a comparison of the execution prices of potential execution venues with a reference dataset. Where available, investment firms may use information for the reference dataset from consolidated tape providers.
2. For the purposes of this Regulation, investment firms may rely on reference datasets where the datasets:
- (a) provide a complete and accurate presentation of the execution prices obtained in the market for the class of financial instrument assessed;
 - (b) include data from the most liquid execution venues for the instruments traded within each class of financial instruments;
 - (c) for classes of instruments which are executed over the counter, including bespoke products, the reference dataset shall contain market data which enables the investment firm to assess the fairness of the price proposed to the client in accordance with Article 64(4) of Commission Delegated Regulation (EU) 2017/565.
3. Where an investment firm selects only one execution venue to execute client orders for a given class of financial instruments, or for all client orders, the firm shall set out in its order execution policy a justification explaining how selecting only one execution venue ensures that it obtains the best possible result for clients on a consistent basis.

Article 4

Order routing criteria

1. Where a client order may be executed on two or more execution venues included in the list referred to in Article 2(2), an investment firm shall specify in its order execution policy the criteria and their relative importance for identifying the execution venue where it expects to obtain the best possible result for executing a client order in accordance with Article 27(1) of Directive 2014/65/EU.
2. Where an investment firm executes orders on behalf of retail clients, it shall take into account the criteria that have a direct impact on the total consideration as set out in Article 27(1) of Directive 2014/65/EU.
3. When determining the criteria referred to in paragraph 1, the investment firm shall take

into account at least the following:

- (a) the class of financial instruments;
 - (b) whether the client is a retail or a professional client;
 - (c) all costs directly related to the execution of the order, including any fees and commissions charged by the investment firm itself;
 - (d) the size and nature of the order;
 - (e) market data, including historical market data, where relevant and available.
4. Where an investment firm uses an automatic order routing system, the investment firm shall specify in its order execution policy the main characteristics of the system and the arrangements in place to ensure that the automatic order routing system takes all sufficient steps to obtain the best possible result for their clients.

Article 5

Client instruction

1. Investment firms shall set out in their order execution policies the arrangements for dealing appropriately with specific instructions from clients, including the impact of instructions on the requirements included in Article 3 and the ability of the investment firm to obtain the best possible result for the instructing client.
2. Investment firms shall define in their order execution policies how to differentiate between orders with and without specific client instructions. Investment firms shall at least describe that a specific client instruction involves one of the following:
 - (a) a choice of one option out of multiple options offered by the investment firm related to a part or aspect of the order;
 - (b) an instruction to the investment firm to handle the order in a different way than foreseen by the order execution policy.
3. Where an investment firm receives a specific instruction, the investment firm shall only treat the part or aspect of the order specified by the client as a specific client instruction. For all other parts and aspects of the order, an investment firm shall ensure its order execution policy provides that they are processed in the same way as orders without specific instructions.
4. Where an investment firm offers a retail client the choice of execution venue, the investment firm shall include the following details in its order execution policy:
 - (a) an explanation of how the policy prevents inducing a client to choose a specific execution venue;

- (b) if the commissions charged differ per execution venue, an explanation of how the investment firm complies with Article 64(3) and Article 66(5) of Commission Delegated Regulation (EU) 2017/565;
- (c) that clients are offered the possibility not to specify a specific execution venue, which means that the choice of the execution venue is the responsibility of the investment firm, including obtaining the best possible result for the execution of the order;
- (d) that the order will be routed in accordance with the investment firm's order execution policy if the client does not choose the execution venue.

Article 6

Dealing on own account when executing client orders

1. Where the order execution policy of an investment firm permits it to execute orders by dealing on own account, the investment firm shall specify in that policy the following:
 - (a) how the investment firm obtains the best possible result for its clients in accordance with Article 27(1) of Directive 2014/65/EU when executing client orders through dealing on own account;
 - (b) the measures implemented to identify, prevent and manage the conflicts of interest related to executing client orders through dealing on own account;
 - (c) how the firm assesses the additional risks for clients when executing client orders through dealing on own account;
 - (d) the steps taken by the firm to comply with the obligations set out in Articles 68 to 70 of Commission Delegated Regulation (EU) 2017/565;
 - (e) where the investment firm executes client orders in OTC products in accordance with Article 64(4) of Commission Delegated Regulation (EU) 2017/565, how the fairness of the price proposed to the client is ensured.
2. Where the order execution policy of an investment firm permits it to execute orders by dealing on own account, the investment firm shall check the fairness of the price proposed to the client by taking into account the price of the financial instrument observed on the market at the time of the transaction. If no reliable price is available, the investment firm shall establish the reference price through the market price of other similar, comparable, or underlying financial instruments. In the absence of reliable prices for such similar, comparable, or underlying financial instruments, the investment firm shall use an internal pricing model, based on reliable and accurate data reflecting market conditions.

Article 7

Monitoring of the order execution policy

Investment firms shall monitor the effectiveness of their order execution policy, including the following elements:

- (a) whether client orders are executed in compliance with the order execution policy;
- (b) the quality obtained in executing client orders through their order execution arrangements;
- (c) the price of execution taking into account a reference dataset. Where available, investment firms may use information for the reference dataset from consolidated tape providers;
- (d) for each class of financial instruments, predetermined thresholds for relevant indicators as to whether the execution quality is obtained on a consistent basis, including:
 - (i) the accepted deviation of the clients' execution price from the relevant value of execution prices in the reference dataset;
 - (ii) the minimum percentage of traded volume that meets the relevant values of execution prices in the reference dataset;
 - (iii) the minimum number of client transactions that meets the relevant values of execution prices in the reference dataset;
- (e) at least a representative sample for each class of financial instruments;
- (f) all other factors relevant to the execution of the order as set out in Article 27(1) of Directive 2014/65/EU;
- (g) other relevant indicators to assess compliance with the order execution policy and the quality of execution obtained by the firm.

Article 8

Periodic assessment of the effectiveness of the order execution policy

1. Investment firms shall periodically assess the effectiveness of their order execution policy:
 - (a) at least annually;
 - (b) whenever the monitoring of the execution quality in accordance with Article 7 of this Regulation provides indications that the investment firm may not comply with its order execution policy or the requirements of Article 27(1) of Directive 2014/65/EU;
 - (c) whenever a material change occurs that affects the ability of the investment firm to

continue to obtain the best possible result for its clients.

For the purposes of point (c), a 'material change' means a material change as referred to in Article 65(7), fourth subparagraph, of Commission Delegated Regulation (EU) 2017/565.

2. The periodic assessment referred to in paragraph 1 shall include at least:
 - (a) the costs and fees charged to the investment firm as referred to in Article 3(1)(e);
 - (b) the results of the monitoring performed in accordance with Article 7;
 - (c) financial market developments, such as liquidity dry-ups and their impact on the obtained and expected execution quality of the selected execution venues and their ability to obtain the best possible result for the client orders of the investment firm on a consistent basis;
 - (d) the emergence of new execution venues, including new functionalities, fee structures, transparency in price formation and levels of liquidity or execution services.
3. Where an investment firm selected only one execution venue to execute client orders in a given class of financial instruments or all client orders, the investment firm shall in addition assess periodically whether executing on one execution venue continues to ensure that the investment firm obtains the best possible result for clients on a consistent basis. As part of the assessment, the investment firm shall make a comparison to available alternative execution venues.
4. Investment firms shall update their order execution policies and internal arrangements to correct any deficiencies of effectiveness identified in their periodic assessments within a reasonable period after the conclusion of the assessment, based on the seriousness of the deficiency.

Article 9

Classes of financial instruments

1. Investment firms shall identify classes of financial instruments for which they execute orders on behalf of clients in the manner set out in the Annex to this Regulation.
2. Investment firms shall, in addition, identify separate subclasses of financial instruments within those referred to in the Annex in either of the following circumstances:
 - (a) where a significant number of orders is executed or is expected to be executed in financial instruments with different methods of execution within the same class of financial instruments, as referred to in the Annex;
 - (b) where the classes set out in the Annex do not allow for an effective monitoring and assessment of execution quality.

Article 10

Repeal

Commission Delegated Regulation (EU) 2017/575¹⁴ and Commission Delegated Regulation (EU) 2017/576¹⁵ are repealed.

Article 11

Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply from [18 months after entry into force].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels.

For the Commission

The President

¹⁴ Commission Delegated Regulation (EU) 2017/575 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards concerning the data to be published by execution venues on the quality of execution of transactions (OJ L 87, 13.3.2017, p. 152).

¹⁵ Commission Delegated Regulation (EU) 2017/576 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution (OJ L 87, 31.3.2017, p. 166).

ANNEX

Classes of financial instruments

(a)	Shares and depository receipts	The 'transferable securities' referred to Article 4(1), point (44)(a), of Directive 2014/65/EU.
(b)	Exchange traded funds, exchange traded notes and exchange traded commodities	'Exchange traded funds' as defined in Article 4(1), point (46), of Directive 2014/65/EU. 'Exchange traded commodities' and 'exchange traded notes' as referred to in Table 2 of Annex IV of Commission Delegated Regulation (EU) 2017/583 ¹⁶ and further specified in Table 2.4 of Annex III thereof.
(c)	Certificates and other equity-like financial instruments	'Certificates' as defined in Article 2(1)(27) of Regulation (EU) No 600/2014 ¹⁷ . 'Other equity-like financial instrument' as referred to in Table 2 of Annex III of Commission Delegated Regulation (EU) 2017/587 ¹⁸ .
(d)	Bonds and money-market instruments	For 'bonds', the transferable securities referred to in Article 4(1), point (44)(b), of Directive 2014/65/EU. 'Money-market instruments' as defined in Article 4(1), point (17), of Directive 2014/65/EU.
(e)	Structured finance products	As defined in Article 2(1), point (28), of Regulation (EU) No 600/2014.

¹⁶ Commission Delegated Regulation (EU) 2017/583 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of bonds, structured finance products, emission allowances and derivatives (OJ L 87, 31.3.2017, p. 229).

¹⁷ Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 84).

¹⁸ Commission Delegated Regulation (EU) 2017/587 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on transparency requirements for trading venues and investment firms in respect of shares, depository receipts, exchange-traded funds, certificates and other similar financial instruments and on transaction execution obligations in respect of certain shares on a trading venue or by a systematic internaliser (OJ L 87, 31.3.2017, p. 387).

(f)	Options and futures admitted to trading on a trading venue	'Options' and 'futures' as referred to in Section C (4) to (7) and (10) of Annex I of Directive 2014/65/EU.
(g)	Other derivatives	Financial instruments as referred to in Section C (4) to (8) and (10) of Annex I of Directive 2014/65/EU, except options and futures admitted to trading on a trading venue.
(h)	Contracts for difference	Financial instruments as referred to in Section C (9) of Annex I of Directive 2014/65/EU.
(i)	Emission allowances	Financial instruments as referred to in Section C (11) of Annex I of Directive 2014/65/EU.
(j)	Other instruments	Financial instruments that do not fall within the definition of the classes (a) to (i) above.