

30 January 2018

Circular to licensed corporations on best execution

This circular sets out guidance on the standards of conduct and internal controls the Securities and Futures Commission (SFC) expects of licensed corporations (LCs) in delivering best execution.

The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) requires that a licensed or registered person executes client orders on the best available terms¹ to deliver best execution. The SFC expects LCs to have in place arrangements, including controls, monitoring and management supervision, to obtain the best available terms. Such arrangements should be subject to periodic review to ensure best execution is achieved consistently.

The SFC recently conducted a thematic review² of selected LCs to assess the effectiveness and adequacy of their arrangements for delivering best execution. In the [Report on the Thematic Review of Best Execution](#), issued today, the SFC shares detailed observations from the review and points out good industry practices for LCs to take into consideration.

The speed and complexity of trading have increased and execution is now mainly automated and electronic. LCs offer multifaceted products and services, including many products with unique features. In light of these developments and the results of the thematic review, the SFC provides further guidance on best execution as set out below.

1. Governance and management supervision

Sufficient management oversight should be in place to ensure that trade exceptions and other matters related to best execution are brought to management's attention for timely review.

Policies and procedures regarding best execution should be established to cover different types of financial instruments, including both listed and over-the-counter products, and should be reviewed and updated on a regular basis.

At a minimum, these policies and procedures should address the following areas:

- factors to be considered in delivering best execution;
- applicability of best execution and carve outs;
- monitoring and control mechanisms to review execution quality of trades; and
- the respective roles of the operational and control functions in ensuring best execution.

¹ Paragraph 3.2 of the Code of Conduct. Also see paragraph 3.2 of the Fund Manager Code of Conduct.

² The SFC announced the thematic review in the "[Circular to Licensed Corporations – SFC notifies the industry of review on best execution and client facilitation](#)" issued on 4 November 2016.



Where applicable, these policies and procedures should also address:

- handling clients' orders in cases where multiple quotes exist and where pricing information is insufficient or quotes are absent; and
- disclosure to clients of best execution arrangements including carve outs and the exclusive use of affiliates, connected parties and third parties.

All relevant staff should be provided with periodic training on best execution as well as updates on internal policies and regulatory and technological developments.

2. Best execution factors

Sufficient steps should be taken to obtain the best available terms when executing client orders, taking into account price, cost, speed of execution, likelihood of execution, speed of settlement, likelihood of settlement, size and nature of the order and any other relevant considerations.

The relative importance of each best execution factor may vary from case to case and best execution of certain types of instructions should be assessed against multiple factors. Where a client has given specific instructions which cover one part or aspect of an order, this should not be treated as releasing LCs from their best execution obligations for other parts or aspects of the order.

3. Applicability of best execution

When LCs enter into agency or back-to-back principal transactions³ with clients, the obligation to deliver best execution remains with LCs where clients rely on LCs to protect their interests in order execution.

When LCs enter into principal transactions with clients, other than those which are back-to-back in nature, LCs should carry out their own assessments to determine whether clients are relying on LCs to protect their interests, and whether the best execution obligation is owed, before applying any carve outs.

4. Responsibilities of execution staff

Execution staff and their supervisors form an important first line of defence in the trade execution process. Reasonable diligence should be demonstrated in handling client instructions, monitoring execution outcomes and, where applicable, taking steps to obtain multiple quotes. In the absence of multiple quotes, execution staff should obtain sufficient pricing information on a best-effort basis to validate quotes provided to clients.

³ Under paragraph 8.3 part A of the Code of Conduct, back-to-back transactions refer to those transactions where a licensed or registered person, after receiving –
(a) a purchase order from an investor, purchases an investment product from a third party and then sells the same investment product to the investor; or
(b) a sell order from an investor, purchases an investment product from the investor and then sells the same investment product to a third party,
and no market risk is taken by the licensed or registered person.



5. Controls and monitoring

Controls and monitoring carried out by second and third lines of defence, such as compliance and internal audit functions, should be in place to review the quality of execution and to detect and address anomalies. Based on the characteristics of different financial instruments and the complexity and scale of the LCs operations, it should determine appropriate metrics and reference benchmarks to assess execution quality.

6. Arrangements with affiliates, connected parties and third parties

Due diligence should be carried out on affiliates, connected parties or third parties engaged for execution, and a systematic process should be in place to continuously monitor execution outcomes. LCs should take action to ensure that execution arrangements with affiliates, connected parties and third parties do not undermine the delivery of best execution. Regardless of whether orders are executed through affiliates, connected parties or third parties, the obligation to deliver best execution remains with LCs.

The SFC will continue to monitor market and regulatory developments and may propose further measures.

Should you have any questions regarding the content of this circular, please contact the relevant case officers in charge.

Intermediaries Supervision Department
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End

[SFO/IS/005/2018]