Best Execution when executing client orders

This information memo is based on new EU legislation (MiFID II and associated legislative acts, valid in the EU from 3 January 2018).

1. Introduction

According to MiFID II, investment firms have an obligation to take all sufficient steps to obtain the "*best possible result*" for their clients when executing client orders. Price, costs, speed, likelihood of execution and settlement, the order size and nature and any other consideration relevant to the execution of the order shall be taken into account. This obligation is one of the main foundations of the client protection afforded by MiFID II.

The provision slightly tightens up the legislation that applies until 3 January 2018, according to which the obligation is to take "all reasonable steps" for the client when executing client orders.

MiFID II stipulates that firms must have effective systems, procedures and arrangements to ensure compliance with this obligation. Among other things, firms must have an order execution policy ("the Order Execution Policy"). For each type of financial instrument that the firm trades, the Order Execution Policy shall provide information on

(i) the various execution venues used by the firm, and
(ii) the factors that determine the choice of execution venue.

In this context, an execution venue means

- a regulated market,
- an MTF (a multilateral trading facility),
- an OTF (an organised trading facility),
- a systematic internaliser.
- a market maker or other liquidity guarantor or an entity that carries out similar functions and is resident in a state outside the EEA.

The Order Execution Policy shall state the factors that influence the choice of execution venues. These will usually be the type of client and order, the financial instrument's properties and the conditions stipulated by the execution venues to which the order can be sent. In this context, it must be mentioned that MiFID II stipulates strict conditions for an investment firm to be able to receive monetary or non-monetary benefits for executing orders at a specific trading venue or execution venue. Any such benefits must not be seen to entail a conflict of interest and must meet the rules' requirements for receiving benefits from a third party. It is also prohibited for an investment firm to structure or impose commission in such a way that it discriminates unfairly between execution venues.

There are special requirements regarding the content of the Order Execution Policy relating to the transmission of orders and portfolio management. Attached to this memo is a draft Order Execution Policy that meets MiFID's minimum requirements for the content of such a policy. This is intended as an illustration and a starting point that must be adapted by the individual firm.

There is an exception to the requirement that the Order Execution Policy must be used if there is a specific instruction from the client, for example in the case of online broking. The firm must always comply with specific instructions provided there are no grounds for it being impossible to agree to the instructions.

Before an order is executed, the firm must obtain the client's consent to the Order Execution Policy. In addition, express consent is required in order to execute orders outside a trading venue. A trading venue is a generic term for a Regulated Market, MTF and OTF. Such consent may, for example, be given via a client agreement.

If requested by the client, the firm shall document that it has executed the order in accordance with the Order Execution Policy. The firm must also regularly assess whether the execution venues covered by the Order Execution Policy provide the Best Execution for the client or whether there is a need to amend the Order Execution Policy.

2. Best Execution

According to MiFID II, the firm has an obligation to take all sufficient steps to achieve the "best possible result" for the client.

In the English version of the statutory wording of MiFID II, the expression "take all reasonable steps" has been replaced by "take all sufficient steps". As mentioned at the beginning, this entails a certain tightening up of the obligations stipulated in the provision.

The change to the wording of the provision does not, however, change the general obligation entailed by the Best Execution standard. The tightening up is more aimed at the firm's duty to be "up to date" as regards having procedures and systems to achieve Best Execution consistently, and to have effective systems for monitoring that Best Execution is achieved.

This means firms must make sure they can achieve the intention of Best Execution on an "ongoing" basis when creating their Order Execution Policy and establishing procedures and systems for executing client orders.

This obligation means the firm must monitor not only the quality of its execution but also its own systems in order to be able at any time to make the appropriate changes, for example in cases where the firm offers new products or services to its clients.

When assessing what will be the Best Execution, the firm must take into account price, costs, speed, likelihood of execution and settlement, the order's size and nature and any other consideration relevant to the execution of the order.

The scope and content of the obligation to achieve Best Execution will vary, depending on a number of factors, including the client, firm and type of financial instrument.

2.1. Type of client

The obligation to take all sufficient steps to obtain Best Execution for the client applies to professional clients that are not eligible counterparties and to retail clients. However, the obligation is more extensive with regard to retail clients. For the sake of good order, please note that eligible counterparties may request to be classified as professional clients.

2.2 Type of firm

The Securities Trading Regulations impose a Best Execution requirement on investment firms in various ways, depending on the type of investment service that is provided. Firms that *execute* orders on behalf of a client are, as previously stated, subject to the Best Execution requirement. In addition, firms that *transmit* orders to other firms will be subject to a Best Execution requirement. This applies to both firms that transmit orders as a separate investment service and firms that *transmit orders under a valid management agreement*. Despite the rules governing transmitters and executors being rather different, the main obligation will be the same for both types of firms: to take all sufficient steps to obtain Best Execution for their clients. This means that an investment firm which transmits orders to other investment firms must make sure that these firms have an order execution policy, systems and procedures which ensure Best Execution. The firm transmitting orders must similarly regularly monitor the quality of the order execution carried out by the firms used to execute orders and must annually assess their order execution policy.

2.3. Type of financial instrument

The starting point is that all financial instruments are covered by the Best Execution rules. However, firms will meet the obligation in different ways depending on the type of financial instrument and available market for the instrument. In Norway, there is often only one relevant execution venue for financial instruments, so that an assessment of alternative execution venues will be irrelevant. In these cases, the obligation will be less extensive than it is for financial instruments where several execution venues are available.

2.3.1 OTC products

OTC products are financial instruments that (1) have not been listed for trading or (2) are not traded in a regulated market, an MTF or an OTF.

Trading in OTC derivatives normally takes place by individual agreements being entered into between the client and the firm, according to which the client undertakes to either sell or buy an underlying asset at a future date and at a pre-agreed price. Normally, either the firm or a clearing house will guarantee the performance of the derivatives contract. During the term of the contract, there will not normally be any sale of the contract as such. Any sale of the contract during the term of the contract will take place by the contract being redeemed from the firm or clearing house and the firm or clearing house issuing a new contract to a different party. It is thus unnatural to use concepts such as "orders", "trade" and "secondary markets" in connection with OTC derivatives such as shares. The Best Execution provisions will not apply in full to such financial instruments.

However, there are provisions applicable to all types of OTC products, whereby order investment firms shall check the reasonableness of the price proposed to the client. This is to take place by gathering market data used to estimate the price of such products or, if possible, by a comparison with similar or comparable products. The firms must thus be able to document the reasonableness of the price offered to the client using gathered market data.

2.3.2 Price-driven markets (systematic internalisers and market making)

The Best Execution provisions basically also apply when the firm is dealing with the client on its own account. In practice, the provisions must be interpreted as including a provision regarding the way in which the market for certain types of financial instruments functions in practice, including the clients' expectations of being protected by the Best Execution rules.

Interest and currency products are normally traded differently to shares. In practice, the interest and currency market is regarded as a quoting market or price-driven market, unlike the stock market, which is an order-driven market. It will often be the client who takes the initiative to trade with a "request for a quote", i.e. the client asks the firm for a price for a specific volume of a financial instrument.

Regarding a financial instrument where the firm quotes prices as a systematic internaliser or market maker (standardised options, bonds, currency and interest derivatives), the firm publishes buy and sell prices based on its own assessments of the market conditions. The market will usually be transparent, since prices are published on the firm's website or by an information distributor. Clients can thus compare the prices of the various firms. These prices will be either indicative or binding for a specific volume per transaction. If the prices are indicative, the firm will give the client a binding price if the client contacts the firm. After contacting the firm, the client is free to accept or reject the offer. If the client accepts the price, the firm will become the opposite party to the transaction.

In this market, the client will normally be a professional client that is "shopping around" various investment firms for a price for the relevant financial instrument. In these cases, the investment firm cannot be expected to be subject to the Best Execution rules in relation to the client.

We thus assume that the Best Execution rules will not normally apply to trades in the interest, bond and currency markets as long as they are the type of trades described above. In any case, it would be unnatural for a firm to have to refer the client to a competing firm that, while purchase or sales negotiations are ongoing, provides a better price than the referring firm.

This interpretation is also supported by the fact that the Commission, in connection with the MiFID I Best Execution rules, has stated that firms may use the so-called "Four-fold legitimate reliance test" to assess whether or not the Best Execution rules are to apply.

According to this test, the assessment of whether the Best Execution rules are applicable to the quoting market or price-driven markets will depend on the following factors:

- Who takes the initiative to carry out these transactions: the client or firm?
- Is the client professional or retail?
- How transparent is the market in question?
- Can the client expect to be protected by the Best Execution rules?

There are no statements or provisions in MiFID II to indicate that this approach can no longer be used when MiFID II enters into force.

In connection with this approach, EU authorities have stated that the Best Execution provision applies when a firm takes the initiative to trade with a retail client because a retail client will expect the firm to comply with the Best Execution rules.

There is otherwise nothing to prevent the procedures for trading in instruments that are not subject to the Best Execution requirements from nonetheless being included in the Order Execution Policy. Such information may in any case be useful to the client.

If the trade in products that are normally traded in price-driven markets takes place through an ordinary order placement, the Best Execution rules will be applicable in the same way as for other order placements linked to other financial instruments. This is especially relevant when it is the investment firm that contacts a retail client and advises the client to trade. In these cases, the client must be able to trust that the investment firm is safeguarding the client's interests regarding the price of the financial instrument in question and any other elements in the transaction.

3. Order Execution Policy

3.1. Introduction

According to MiFID II, an investment firm must have effective systems, procedures and arrangements in place to ensure compliance with the obligation to take all sufficient steps to obtain the Best Execution for the client. Among other things, the firm shall prepare and use an Order Execution Policy.

When a client has submitted an order without specific instructions, the firm is to execute the transaction in accordance with the Order Execution Policy so that Best Execution is achieved.

The Order Execution Policy must be shown to the client in writing or via a webpage in plenty of time before the client makes use of the investment service. "In writing" means written on paper, unless the client consents to the information being given on another permanent medium, including in an email. The Order Execution Policy will typically be an annex to a client agreement or the firm's business terms and conditions.

In connection with the preparation and implementation of the Order Execution Policy, firms must carry out a three-stage procedure:

1) Depending on the type of client and the clients' needs, the firm must decide on the factors that are to be given priority when executing orders.
2) Firms must assess available execution venues in order to identify the systems which enable the firm to achieve Best Execution.
3) Firms must send client orders, on an order-by-order basis, to a suitable execution venue, taking into consideration the relative importance of the various factors in accordance with the Order Execution Policy.

3.2 The client's consent

The firm is obliged to obtain the client's "*consent*" to the Order Execution Policy. If the Order Execution Policy allows client orders to be executed outside a trading venue (a regulated market, MTF or OTF), the client must "*expressly consent*" to this.

3.2.1 The Order Execution Policy – "consent"

The most practical way to meet these requirements is for the client to confirm in the client agreement that he/she has accepted the Order Execution Policy and the opportunity to execute trades outside a trading venue. Alternatively, consent may be obtained by a written or electronic signature, by clicking an area of a webpage or verbally during a recorded phone call. It will probably also be sufficient if the client consents by his/her conduct.

This means that a client placing an order after being shown the Order Execution Policy must be regarded as having approved the Order Execution Policy. In order to ensure that this can be proven, however, we recommend that retail clients consent by actively doing something, such as signing the client agreement.

However, the legislation only means that retail clients must enter into client agreements. When dealing with professional clients, it will be less risky to allow the Order Execution Policy to be regarded as having been approved by the client's conduct. This client group will to a larger extent be able to safeguard its own interests.

3.2.2 Trades executed outside a trading venue – "express consent"

3.2.2.1 Understanding the concept of "express consent"

As regards the requirement of "*express consent*" for a trade outside a trading venue, this normally means that consent must be obtained by an act being carried out by both retail and professional clients. The most practical way to obtain such consent is through a client agreement or conversation with the client in a recorded phone call. The consent of *new clients* can be relatively easily obtained when the client relationship is being established and the client agreement is to be signed. However, it can be slightly more demanding to obtain similar consent from *existing clients*.

3.2.2.2 Understanding the concept of "trading outside a trading venue"

As regards which trades are to be covered by the concept of "*trading outside a regulated market*", the EU Commission has in connection with MiFID I issued the following statement. The Commission believes that a trade is to be regarded as having taken place "outside a regulated market" when the execution has taken place in a way that deviates from the regulations that apply to trading in the marketplace in question. This statement means that the trades that, for example, take place outside Oslo Stock Exchange's trading system but in accordance with the trading rules that apply to Oslo Stock Exchange will not be covered by the definition of "trading outside a regulated market" and therefore the firms in these cases will not have to obtain the client's "express consent" prior to the transaction.

3.3. Content requirement

For each type of financial instrument traded by the firm, the Order Execution Policy must contain information on the various trading systems used and the factors that determine the choice of trading system.

The Order Execution Policy may be prepared as one document with various parts for different types of financial instrument or as separate documents, depending on the type of financial instrument and type of client. It must in all cases be specified which Order Execution Policy or parts of the Order Execution Policy are applicable to various types of financial instruments and clients.

A type of financial instrument is financial instruments with the same homogeneous properties, such as shares and equity certificates, bonds and interest-bearing securities, derivatives, etc.

3.3.1 Various execution venues

An execution venue is a regulated market, MTF, OTF, systematic internaliser, market maker or other liquidity guarantor or entity that carries out similar functions and is resident in a state outside the EEA.

The Order Execution Policy shall at least state the execution venues that are used. It is not necessary to choose execution venues that will provide the Best Execution in each individual case. Firms may easily specify that the list of execution venues is not exhaustive but that execution may take place at other execution venues if this is otherwise in accordance with the Order Execution Policy.

Even if there are alternative execution venues, MiFID II does not prevent the Order Execution Policy from only stating one execution venue for a type of financial instrument, provided the firm can demonstrate that the choice of execution venue provides consistent Best Execution for its client(s). However, firms do have an obligation to be up to date on, for example, reports and data that alternative execution venues must publish regarding the quality of their execution. In other words, the firm cannot trust that its choice of execution venue can be maintained over time if reports and data from other alternative execution venues indicate that the Best Execution obligation is not being met by using the initially chosen execution venue. In such cases, it may, for example, be relevant to transmit orders to another investment firm that is a member of or has access to other alternative execution venues.

If only one execution venue is chosen, the firm's method for handling orders will be very important for whether Best Execution is obtained. For example, the result of placing various types of orders in the central order book may be very different from that of placing the order in an opening or closing auction. Similarly, the use of algorithms and smart-order routers may be important to whether Best Execution is obtained on an "ongoing" basis.

3.3.2. Relevant factors

The assessment of what will be the Best Execution is to be conducted based on the following factors:

- Price
- Costs
- Speed
- Likelihood of execution and settlement of the order
- Size of the order
- Nature (special features)
- Other relevant considerations

3.3.3. Criteria for determining the relative importance of the factors

The criteria that will determine the relative importance of the factors determining the Best Execution in each case are to be included in the Order Execution Policy. These will usually be the following:

- The client's properties – professional or retail
- The client order's properties – size, type of instrument, settlement mechanisms
- Properties of the financial instruments – degree of liquidity, how the instrument is normally traded
- Properties of the execution venues – price and costs, ability to handle complex orders, speed, etc

Regarding the client's properties, the abovementioned factors may, as stated, be assigned varying importance depending on whether the order comes from a professional or retail client.

When dealing with retail clients, the best possible result is determined on the basis of the total amount the client is to pay in connection with the order execution.

According to the Securities Regulations, the calculations are to take into account the price of the financial instrument and costs linked to executing the order, including fees for using the execution venue, central counterparties and securities registers and other fees debited by third parties involved in executing the order. In other words, the requirement for obtaining the Best Execution for retail clients is related not only to price but also to reducing the costs incurred in connection with executing the order. Other factors, such as speed and the likelihood of execution and settlement, only take precedence over price and costs if this leads to the Best Execution for the client. The focus must be on the total (net) result for the client.

When choosing between several relevant execution venues, the firm must take into account its own commissions and costs of executing the order at the various execution venues.

Normally, the emphasis placed on price and costs will be more important for a retail client than for a professional client, although this will often also be important for professional clients. For professional clients, the size of the order will often be an important factor when a firm is to decide how to execute the order. Correct and good order handling is especially important here so as, among other things, to avoid large market fluctuations in the instrument. This difference must thus be taken into consideration when the firm determines the relative importance of the various factors in connection with its execution of a client order.

3.3.4 Information requirement

In plenty of time before providing services, the firm shall give clients detailed information about its order execution policy on a permanent medium or a website. The information shall contain:

- an account of the relative importance assigned by the firm to the factors stated in item 3.3.2 (price, costs, speed, etc) or the process that the firm carries out to determine the relative importance.
- a list of the execution venues that the firm to a large extent regards as being reliable for meeting the Best Execution requirement, including which execution venues are used for each type of financial instrument, for orders from retail clients, for orders from professional clients and for securities-financing transactions
- a list of the factors used to select the execution venue, including qualitative factors such as clearing schemes, automatic interruption systems, planned acts and other relevant considerations, and the relative importance of each factor. The information on factors used to select execution venues must be consistent with the checks used by the firm to demonstrate to clients that Best Execution has been achieved on a consistent basis when reviewing the adequacy of its policy and arrangements
- how execution factors such as price, costs, speed, the likelihood of execution and other relevant factors are part of all sufficient steps to achieve Best Execution for the client
- if relevant, information that the firm executes orders outside a trading venue, the consequences of this, including the counterparty risk that arises when executing outside a trading venue and, if required by the client, information on the consequences of this execution method
- a clear and accentuated warning that specific instructions from a client may prevent the firm from taking the precautions that the firm has agreed on as its order execution policy and introduced with the aim of obtaining Best Execution when executing the aforementioned orders with respect to the elements covered by the instructions
- a summary of the selection process for execution venues, execution strategies, procedures and processes used to analyse the achieved execution quality and how the firm checks that Best Execution has been obtained for the client

If the firm uses different fees depending on the execution venue chosen, the firm shall explain these differences in sufficient detail that the client can understand the benefits and drawbacks of choosing a specific execution venue.

If the firm encourages clients to choose a specific execution venue, the firm shall provide fair, clear and not-misleading information so that the client does not choose an execution venue solely on the basis of the firm's price policy.

If the firm lawfully receives payment from execution venues, the firm shall inform the client of this. This information shall state the fees that the firm charges all opposite parties to the transaction and, if the fees vary depending on the client, shall include the maximum fees or scope of the fees that may be imposed.

If the firm demands a fee payment from more than one participant in a transaction, the firm shall inform its clients of the value of all the monetary and non-monetary benefits it has received.

3.5. Updating the Order Execution Policy

The Order Execution Policy is to be updated annually. In addition, it is to be updated when significant changes occur that affect the firm's continued ability to obtain Best Execution for its clients by using the execution venues stated in the Order Execution Policy.

A significant change may, for example, be modifications to one of the factors relating to the execution or an execution venue, such as costs, price, speed, the likelihood of execution and settlement, size, nature or other assessments that are relevant to the execution of the order.

If the Order Execution Policy is amended because changes occur, the clients must be notified. The client's consent is not required for such changes.

4. The client's specific instructions

An order must be executed in accordance with any specific instructions given by the client.

The client may, for example, have stated a limit for how much he will buy for or how low he will sell for, or that the entire order is to be placed in the order book at the same time. If an order is executed in accordance with the client's specific instructions, for example regarding price, the Best Execution requirement will nonetheless apply to the other parts of the order that are not covered by the specific instructions.

Clients are to be given a clear and not-misleading warning that specific instructions may prevent the firm from carrying out the steps stipulated in the Order Execution Policy to ensure Best Execution.

Firms are free to agree with the client in advance that orders received in special situations will be dealt with as specific instructions. The firm may also state in the Order Execution Policy that further specified instructions will be regarded as specific instructions and the consequences of this.

5. Documentation and filing

Orders, order execution information and the Order Execution Policy must be documented and filed, among other things so that clients can later ask the firm to prove that an order has been executed in accordance with the Order Execution Policy approved by the client. As regards the extent of this document filing requirement, we believe that filing the documentation relating to the specific trade in question must be sufficient. It must be possible to obtain general documentation of the prevailing market conditions later on if necessary.

Documentation of compliance with this obligation shall be stored for five years

Annex

Draft of a minimum Order Execution Policy for financial instruments in order-driven markets (shares, primary capital certificates, ETFs)

[Date]

1 Introduction

According to the legislation, investment firms have an obligation to take all sufficient steps to achieve the "*best possible result*" for their clients when executing client orders ("Best Execution"). When it receives a client order, the Firm will carry out a specific assessment of how the order is to be executed to obtain Best Execution.

The order execution policy stated below ("the Order Execution Policy") will form the basis for this assessment.

2 Exemption from the Order Execution Policy – specific instructions

If the client provides specific instructions, this may prevent the Firm from taking the steps stipulated in the Order Execution Policy below to ensure Best Execution. The client and Firm may enter into a separate agreement stating that orders received in special situations are to be treated as specific instructions.

3 Relevant factors when choosing the execution method

When choosing the execution method, the Firm will take into account price, costs, speed, the likelihood of execution and settlement, size, nature and other relevant factors.

4 Relative importance assigned to relevant factors

When the Firm executes client orders, the following elements will be taken into account when determining the relevant importance of the abovementioned factors (item 3):

- The client's properties (retail/professional client)
- The properties of the client's order
- The properties of the financial instruments included in the order
- The properties of the trading systems to which the order may be sent

In dealings with retail clients, the Best Execution will be determined based on the total amount the client is to pay in connection with the order execution.

5 Alternative ways to execute orders

The Firm will execute orders for the client in one of the following ways:

5.1 At an execution venue, such as a regulated market or MTF, OTF, Systematic Internaliser, or market maker:

(a) by placing the order in an execution venue

(b) by transmitting the order to a different investment firm if the Firm does not have access to an execution venue

5.2 Outside a regulated market or MTF:

(c) by buying from or selling to other clients (mutual business)

(d) by itself wholly or partially becoming an opposite party (own account trading)

(e) by transmitting the order to another investment firm with which the Firm cooperates

Re a) [**Here, firms include information on the execution venues that they regard as being suitable for obtaining Best Execution when executing orders]**

The list is not exhaustive. At times, execution may take place at other **execution venues** if this is in accordance with the rest of this Order Execution Policy.

If the financial instrument is traded at **execution venues** (including Oslo Børs (Stock Exchange)/Oslo Axess), the Firm will normally execute the order in Oslo Børs/Oslo Axess, since it believes this method of execution will provide the Best Execution for the client. However, if the Firm believes that the **execution venue** with the highest liquidity for the financial instrument in question will provide the Best Execution for the client, the Firm will execute the order in the **execution venue** where the financial instrument has the highest liquidity.

Re c), if the Firm has received orders to both buy and sell the same financial instrument and these orders can be matched internally, the Firm will normally place the orders in the Oslo Børs/Oslo Axess trading system if the financial instrument is listed on Oslo Børs/Oslo Axess. The trading system will automatically match the orders at the market price. Alternatively, the orders will be executed by the Firm itself concluding agreements on behalf of clients. In such case, the Firm will safeguard the clients' interests with the same care and determine the price of the financial instruments on the basis of the stock exchange price or, if no stock exchange price is available, a price that is reasonable considering the state of the market.

Re d), if the Firm is an opposite party, this will be stated on the contract note or any other confirmation. If the Firm steps in as an opposite party (own account trading) in relation to a client order, this will take place at a price which equals the best obtainable price in a trading system, for example the stock exchange price. Exceptions will apply if the Firm, in its capacity as a market maker and when directly requested by the client, states a price at which the Firm will either buy or sell the financial instruments in question and the client accepts this price.

6 Trading in unlisted shares

If an unlisted share (or another financial instrument) is registered on the Norwegian OTC List, the Firm will place the order as an interest in the OTC system and then contact another firm that has shown a corresponding interest in the OTC system. The Firm will negotiate with this firm to achieve the best possible price for the client.

7 When will the order be executed?

The Firm will start to execute the order as soon as it receives it from the client. This means that the Firm will prioritise orders according to the time when they are received unless the Firm believes that Best Execution will be obtained by aggregating the order with other orders. The Firm reserves the right to aggregate the client's orders with orders from other clients, persons or firms that are or are not affiliated with the Firm. Orders may be aggregated if it is unlikely that aggregation in general will be a disadvantage to any of the clients. However, the client is aware that aggregating orders can in some cases be a disadvantage.

The Firm also reserves the right to aggregate the client's orders with transactions carried out for the Firm's own account. If the total order is only partially executed, the client's order will basically be given priority over the Firm's order. However, exceptions will be made if the Firm could not have executed the trade on correspondingly favourable conditions without the aggregation.

An order received outside the marketplace's hours of business will be executed once the marketplace re-opens.