

A nighttime aerial view of Hong Kong, showing a dense cluster of illuminated skyscrapers and buildings along the waterfront. The lights reflect on the water, and the sky is dark with some light clouds. The overall color palette is dominated by blues, purples, and oranges from the city lights.

Bulletin on Regtech Use Case

Best Execution Services

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Bulletin on Regtech Use Case is a publication published by the Hong Kong Monetary Authority (HKMA). It should be noted that the sole purpose of this publication is to provide Authorized Institutions (banks) with information on the latest regulatory technology (Regtech) developments. The HKMA does not endorse any use cases or solution described in this bulletin. If a bank intends to adopt a particular solution or implementation, it should undertake its own due diligence to ensure that the technology or approach is suitable for its circumstances.

Background

The Bulletin on Regtech Use Case series showcases innovative Regtech solutions implemented by banks. It aims to promote the adoption of Regtech among financial institutions in Hong Kong, enhance their risk management and compliance effectiveness, and facilitate knowledge sharing within the Regtech ecosystem.

This bulletin showcases Best Execution Services such as that offered by ICE which can help financial institutions compare their execution prices of Over-the-Counter (OTC) derivatives with a single reference price in order to demonstrate that the execution has not compromised clients' interests. It can be particularly useful for bespoke and highly exotic instruments where multiple quotes are not available.

Best Execution Services

- Financial institutions are required to implement internal controls and management supervision to ensure best execution. Policies and procedures regarding best execution should be established to cover different types of financial instruments, including both listed and over-the-counter (OTC) products.
- Beyond regulatory requirements, institutions are also analysing the execution of their trades to help achieve enhanced trading and operational performance.
- Leveraging advanced analytics, Best Execution Services provide valuation of OTC derivatives, instruments that can be of very unique in design and structure. Such valuations can serve as reference prices for financial institutions to compare against their execution prices, subsequently to help demonstrate that the execution does not harm the best interest of the end clients.
- Best Execution Services enable the extraction of pricing insights from market and reference data leveraging cleansing technology. Coupled with platforms that offer real-time workflows supported by Application Programming Interfaces.

Use Case

Challenges

- Financial institutions are expected to obtain sufficient pricing information on a best-effort basis to validate quotes provided to clients when multiple quotes are not available.
- Based on the characteristics of different financial instruments, financial institutions are expected to determine appropriate metrics and reference benchmarks to assess execution quality.
- However, for less frequently traded OTC derivatives, there is little-to-no public trade data available, making them difficult to value and thus require large amounts of proprietary or historical data to effectively examine, track and document best execution metrics.
- It is particularly challenging for private banks and wealth management businesses where the majority of trades involve bespoke or complex structures.

Solution

- Best Execution Services for derivatives can help tackle the challenge where there is a lack of multiple quotes of the traded instruments to compare against the institutions' execution price.
- The methodology underpinning Best Execution Services is to compare institutions' execution prices with a single reference price, which is calculated using advanced analytics, incorporating market data sourced from variety of market participants, and with reference to the unique structure of the instrument in question.

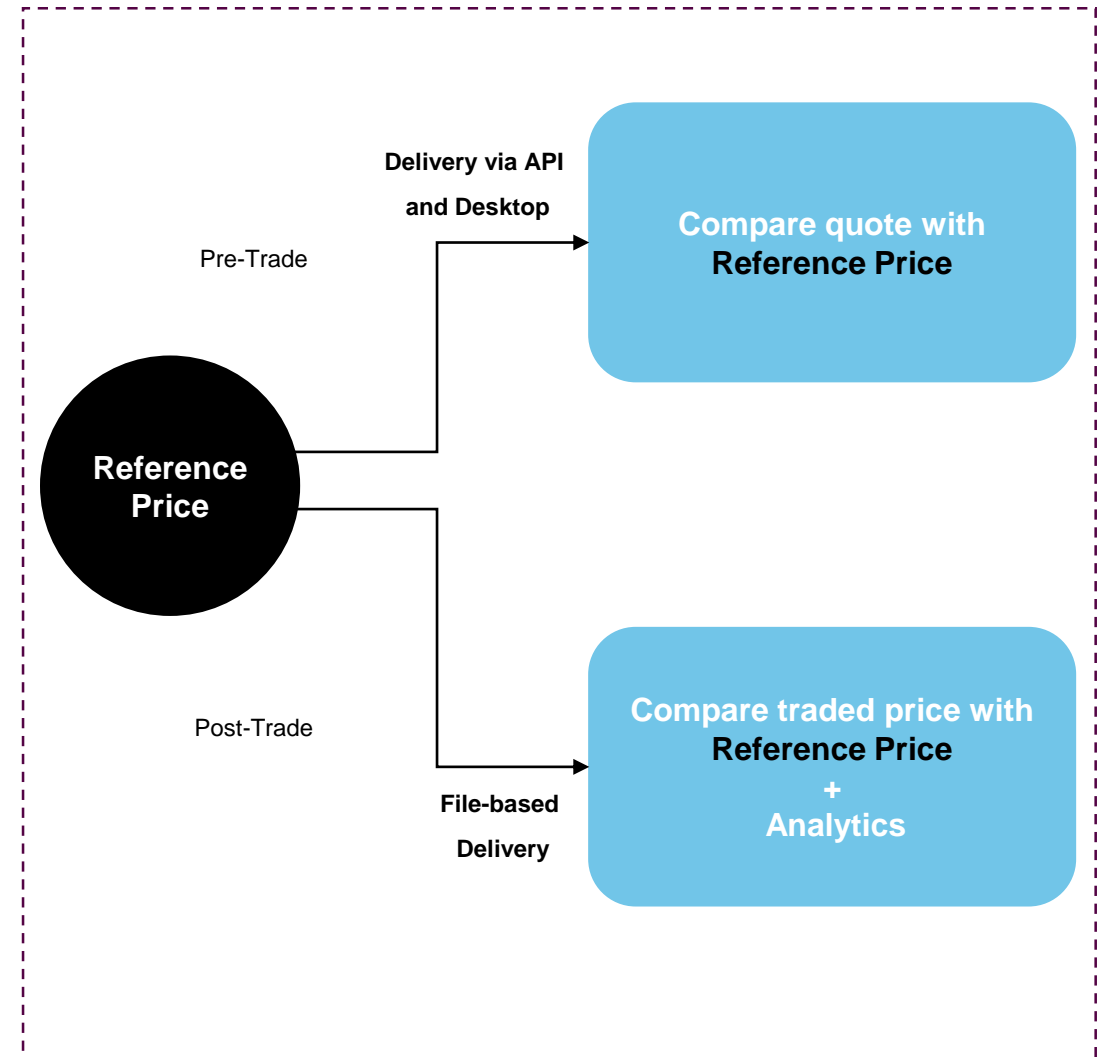
Key Implementation Success Factors

- Certain financial institutions, in particular private banks and wealth management businesses, do not make the market for specific financial instruments. As a result, it would be difficult for them to demonstrate they meet their best execution obligations. Utilising a single reference price can help addressing the essential question of the market's position at the time of execution. Subsequently the institution's compliance team can determine an acceptable tolerance level.

Benefits

How Regtech Helps

- The use of Best Execution Services can be useful for bespoke or highly exotic instruments as multiple quotes may not exist in most cases.
- It can also reflect the broader market landscape more holistically as a wide range of sources and elements are incorporated into the valuation calculation process to arrive at a reference price, which can be used as an important and relevant best execution factor for OTC products.
- The solution can also be used for pre-trade price discovery, enabling institutions to assess execution quality, e.g. to identify counterparties offering more favourable prices. This can help institutions to meet the controls and monitoring requirements on best execution.
- It can provide a positive feedback loop, where traders can make well-informed decisions within parameters set by compliance. This also allows for timely detection of exceptions and outliers.
- The options to calculate and deliver reference prices through various channel such as user interfaces, Application Programming Interfaces (APIs), files and reports, can also provide financial institutions with more flexibility to integrate the process into their workflows.



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