



**H2O**  
Asset Management

## H2O AM LLP

### Best Execution and Broker Selection

**COMPANY CONFIDENTIAL**

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## **1. Brokers Selection Process for Execution**

### **1.1. List of brokers and counterparties (“brokers”)**

The principle at H2O is that no transaction can be undertaken for the portfolios under management outside a pre approved list of brokers.

A list of brokers is put together by the Portfolio Managers and the Operations Department; this is submitted for approval to the Broker Committee. This Committee comprises the following members:

- CEO and Deputy CEO
- CIO and Portfolio Managers
- Head of Trade Processing Operations and Head of Reporting and Reconciliation Operations (Heads of Middle Office Operations)
- H2O Risk

For mandates and dedicated portfolios, the exclusions required by clients apply, and the list of brokers will be updated accordingly. The authorised brokers are monitored in the Order Management system of H2O to allow for pre trade controls for eligibility purpose.

For the portfolios under delegation from OSTRUM, the OSTRUM Broker List applies.

H2O Portfolio Managers can request adding new or cancelling brokers from the approved list. The Risk Control Team can decide to cancel a broker due to information regarding the risk profile or solvency of the broker. This should be approved by the CEO or the Deputy CEO.

### **1.2. Legal framework**

Any dealing activity with brokers should be undertaken within an adequate legal framework:

- ISDA in place for Forex and OTC trades:
  - For mandates or dedicated funds, when clients request such arrangements, a CSA is requested for long-term trades (usually > three month tenure). ISDA negotiations should be started as soon as possible in view of the launch of the mandate. Existing transactions will be covered by the ISDA negotiated.
  - For Ucits, any new Ucit should be added to the executed master ISDA /CSA in place with each broker.
  - For specific managed accounts requiring prime brokerage agreements, the selection of the prime broker will follow the same process and specific ISDA/CSA shall be in place between the prime broker and the executing brokers.
- Repos: GMRA's (or French equivalent when adequate, available & relevant) to be in place
- Securities lending, Oslas (French document when adequate, available & relevant) to be in place
- Futures: Give up agreements to be in place.

When applicable, for mandates mainly (for funds ie UCITS, the OSTRUM list of brokers can apply as it includes all major market counterparties used by H2O with no need to do an additional risk assessment), the brokers will be selected according to the following criteria:

- Risk approval: all brokers are approved by H2O Risk before being integrated into a selection process. The risk control and compliance team will look to ensure KYC/AML is in place:
  - Shareholding structure,
  - Financial results for last two years,
  - Assessment or documents related to the area of expertise of the broker.
  - SSIs for operations
  - Sanctions lists, including countries,
  - Peps (politically exposed persons)

In this regard, H2O will use a scoring process for each broker which is not part of the list provided by OSTRUM, especially for local brokers and brokers offering a specific expertise or liquidity. The scoring process will be based on criteria such as the country of registration and activity of the broker as well as the existence of politically exposed people, and evidence of registration with a regulatory authority.

H2O may request the expertise of the OSTRUM Risk Department to provide a risk assessment of new brokers or counterparties, as they have a dedicated team of experts to assess the creditworthiness of brokers. The OSTRUM list of approved brokers is made available to H2O. H2O Risk may require its Portfolio Managers to provide a specific analysis when relevant.

- Compliance checking: Compliance checks are undertaken before implementation of a new relation, with a specific focus on:
  - Compliance Manual and Compliance Monitoring program
  - Mifid and best execution,
  - Conflicts of Interest Policy
  - Corporate compliance checking:
    - Identity of directors,
    - Companies house registration or equivalent certification of incorporation,
    - Regulatory authority registration including scope of permission and individual approved persons, Trading licences when relevant for broker dealers.
- Quality of service: continuity of service, commercial relations, market information.
- Execution: dealing functions, liquidity depth offered, speed of execution.
- Processing: STP, proportion of failed trades.
- Regulatory and legal requirements.

### **1.3 Operational Framework**

Before inception of a new broker or counterparty, the Heads of Middle Office Operations of H2O makes sure that all SSIs (Standard Settlement Instructions) are available and have been added to the operational platform used. The capacity of OSTRUM to integrate the details of new brokers and counterparties into the systems is of particular importance, in order to allow for a smooth processing of transactions.

If the respective Heads of the Middle-Office Operations evaluate that the operational risk associated with the new broker or counterparty cannot be reasonably mitigated, they will

have a right of veto. This may change if the technical details or parameters of the Broker's Process are improved and tested.

It is also under the responsibility of the Head of Trade Processing Operations to manage the give-up agreements and documentation with the relevant clearing brokers or prime brokers. This applies to all Ucits portfolios, segregated mandates and managed accounts at H2O. One pre-requisite is that brokers use delivery versus payments mechanisms or platforms when they are available, such as for securities, or Forex matching platforms. No bonds or equities can be traded at H2O if they are not settled with DVP systems.

#### **1.4. Periodicity of Selection**

The list of brokers is revised a least once a year or when needed. Either the Portfolio Managers or the H2O Risk can trigger a revision process.

#### **1.5. Approval of the broker list**

The updated list of brokers as it is approved by the broker selection committee, is signed by the CEO or the CIO and the Deputy CEO, and submitted for information to the Executive Committee. It is also transmitted for information to the weekly Compliance & Risk Monitoring Committee.

#### **1.6. Reporting on activity with brokers**

The reporting on activity with brokers is available online, in a dedicated database developed by H2O, with direct feed from the record keeping tools used, allowing for a daily update of all the data and transactions. The reporting is also made formally to the Broker Selection Committee, and that information will be reported to the Executive Committee as well. It is the responsibility of operations to maintain the broker data and transactions database.

#### **1.7. Exception to the broker list**

Any exception to the broker list has to be requested by Portfolio Managers from the Risk and Compliance Department. This is related to specific trades where liquidity or opportunities may justify using such a broker. The broker is not however included in the Brokers List on a permanent basis, as this requires the approval of the Broker Selection Committee.

### **2. Best Execution and Related Controls.**

When Portfolio Managers undertake transactions, they have to check that an audit trail is available. Controls on execution aim at controlling that an audit trail is available for each trade, and that all trades are undertaken by authorised persons at H2O within the list of brokers, or authorised exceptions, with a timely execution and allocation, and ensure best execution.

An automated file is sent to the Operations, Risk, and Compliance teams on a daily basis, incorporating the following controls:

- Timely allocations
- High/Low breaches
- Split consistency
- Best Execution

- Slippage (market manipulation)
- Cancelled trades
- Authorised brokers
- Volcker rule (Super 23A-B)

The compliance department then undertakes a full review of this file and sends their final report to the Counterparty Relationship Manager who is in charge of remedying any potential breach.

## **2.1. Execution venue and Audit trail**

### a) General principles:

The operational platform and controls have been organised to adapt to the breakdown of the transactions by instrument type: as futures listed derivatives and forex represent up to 90% of the total trades depending on portfolios, and are traded on electronic platforms provided by investment banks, the execution and controls processes have been built based on the connectivity with those platforms. The other transactions are cash management transactions including repos and short term instruments, as well as cash bonds and cash equities which are mostly executed using electronic platforms and venues as well.

Since all trades are executed directly by Portfolio Managers, it is their initial responsibility that an audit trail is made available for all trades. Additionally, as all trades are processed on trade date, all trade details are input into the systems by portfolio managers before matching with counterparties by the operations of H2O.

### b) Breakdown by instruments traded:

- Electronic platforms which currently represent up to 90 % of trades for listed derivatives and Forex trades, including spot, forwards, swap:

All trades are executed as much as possible on electronic platforms, in order to provide an audit trail, with all relevant data stored and made available, including the amount, price, time stamps and allocation.

Portfolio Managers input into the platforms all portfolios which may be eligible to their trades, ie all portfolios which are covered by the ISDA governing the relations with the bank providing the electronic platform. Portfolio managers are requested to make their electronic platforms available for audit purposes to H2O Risk.

For all electronic platforms, specific size order limits and markets eligibility rules are input for each portfolio manager of H2O by the broker with prior review and approval of the risk department of H2O. This will allow for a mitigation of the operational risk pertaining to execution (for ex fat finger risk).

The daily controls trade file put together by the operations of H2O downloads the trade details from the electronic platforms through the order management system.

- Trades executed on the phone:

All Portfolio Managers' positions using Etrali platforms are recorded, and all trades details are input into the order management system.

- Trades including bonds executed using the Bloomberg chat:

Portfolio Managers will input all trades into the order management system to allow for same day processing. They will also make their chat accessible for audit purpose to H2O Risk, as they may be requested to print and make the IB message available for monitoring and audit.

- Trades including Cash Equities:

Portfolio managers will input their trades into the CRD order management system made available by OSTRUM, which will allow for a direct download into the trade processing tool and automated matching.

- Cross trades: refer to Cross Trade Policy.

There is no direct cross trade as H2O never holds the assets of its clients. All trades between portfolios are undertaken through market counterparties. A request is sent for pre-authorization by Portfolio Manager to the Risk and Compliance Department with indication of the buying and selling portfolios and the security.

The request highlights the rationale of the cross trade, and the related ad hoc documentation (a specific form for cross trades has been put together) which will always include evidence of the savings on the Bid / Ask price compared to a direct market transaction where the bid ask spread would be wider.

Once the pre-approval is granted by the Risk and Compliance Department, the operations of H2O are in charge of making sure that all the documentation pertaining to the trade including the related exchange of e mails, market price reference, and cross trade specific form, is kept in a specific folder for audit trail purposes, and to measure the P & L amount saved and associated with the specific trade and the existing cross trades.

The related documentation is signed by both the portfolio manager and the person in charge of risk controls and compliance at H2O.

b) When trades are not executed on electronic platforms, or using IB chat:

all trades are input in the Order management system by portfolio managers with all relevant details. This allows for the same day processing of the trade and the monitoring of the trade for controls purpose and including best execution and allocation monitoring purpose.

c) For off-site trades as well as off-hours trades executed with brokers:

- Those trades should remain exceptions, as the goal of H2O is to favour a full STP from trading to Nav calculation, with audit trail available at each stage.

However, given the need to provide constant liquidity to clients, as well as evolution of market circumstances, it may be that offsite and off hours trading is requested in the best interest of the clients.

- Audit Trail: Portfolio Managers make sure that an audit trail is available. Trades executed using Bloomberg chats are available and transmitted with the necessary documentation to the operations of H2O. Other trades are directed by the Portfolio Managers to specific futures broker authorised by the Broker Committee or the Deputy CEO when needed for offsite trades.



- The confirmation from the brokers: it shows all needed information on the trade including the trade executed, size, price, portfolio of allocation and time of execution. Those confirmations are sent to the H2O AM Middle-office.
- Controls: they show that all relevant information on the trade is retrieved: Portfolio Manager, venue, B/S, amount, portfolio of allocation, price with relevant time stamps.

## **2.2. Broker selection**

- All trades are executed according to the list set up as an output of the broker selection process.
- Any exception is reported to the Portfolio Manager who has executed the trade, in order for him to properly document the exception. It should be escalated to the Deputy CEO afterwards.

## **2.3. Timely Execution**

The controls undertaken on a daily basis should monitor that all trades are executed within a reasonable time frame, and at least should indicate the time of execution to allow a further monitoring of the market price action.

## **2.4. Allocation of trades**

The allocation controls undertaken on a daily basis by operations monitors that trades are allocated according to the initial intention of the relevant portfolio manager within a reasonable time frame, i.e. before the trade is matched on trade date with counterparties.

The audit trail is automatically available for all listed derivatives and forex trades as well as securities executed on electronic platforms, which is favoured by H2O due to good liquidity and transparency, as well as the existence of automated interface with its monitoring systems and straight through processing.

- For trades undertaken on electronic platforms:

The daily controls undertaken by operations monitors that the allocation is done based on the standard split, i.e. for the portfolios which are all under the ISDA signed with the relevant counterparty for the portfolios and coded in the electronic platform of the investment bank. The intention is to monitor the allocation according to the pre allocation indicated by the portfolio manager in the platform at the time of execution, where he should select the portfolios concerned by the transaction. The allocation is based on the AuM and relative risk budget of the portfolios, taking into account the inflows and outflows for each portfolio for the relevant day.

The operations and compliance will also monitors that the audit trail of the platform indicates which trades are allocated following the standard risk budget allocation and the ones which are not.

For trade undertaken for the managed accounts involving prime brokers, the rule is that they are allocated based on the average price traded by the portfolio manager for the day. The audit trail for the average rate calculation is provided by the electronic platform. The control trade file put together by H2O will show evidence of the allocation according to the average price traded on the platform.

The automated daily file for all trades indicates the time of execution and the time of allocation. It should in particular highlight all trades allocated late either for technical reasons, such as late trades in the US allocated the following morning early as the systems are closed the day before, or when trades are allocated based on an average execution rate as it is calculated by the platform. Under those circumstances the allocations do not run counter to the interests of the clients, as the allocations are done at the same price for all portfolios, in line with the principle of equality of treatment of clients.

When by exception the allocation is not standard (ie no split among various portfolios which may be eligible to the trade) but made in accordance with the AuM and risk budget of the portfolios, the Counterparty Relationship Manager coordinates with the relevant Portfolio Manager to clearly document the final allocation, with any relevant document including the time of execution and allocation.

This will also be the case when execution is undertaken by a specialised portfolio manager (ex-emerging markets) who is executing a transaction on behalf of several portfolios where no electronic platform offering sufficient liquidity and connectivity may not be available. In this instance, the relevant portfolio manager will prepare a specific excel spread sheet prior to the trade where the allocation will be detailed. This excel spread sheet will be the audit trail for the control of allocation especially when the transaction is not executed for the full size requested by the specialised portfolio manager.

- For trades executed on the phone: if the allocation is the standard one among the portfolios, i.e. depending on their AuM and risk budgets, the allocation time is controlled based on the download of data input by portfolio managers into the order management system. If it is not the standard one, it is then adequately documented by the Compliance department in coordination with the Portfolio Manager.

- For out of hours and off-site trades: the broker confirmation, or the mail sent by the broker should clearly mention the allocation to portfolios. This is kept by the Operations Department.

- No allocation can be modified by portfolio managers after trade confirmation with the counterparty, unless for clerical errors where the pre agreement of the compliance officer is requested and documented (no impact on the portfolio's NAV).

## **2.5 Best execution**

H2O has a strong commitment to implement best execution for all trades and instruments.

- For Forex and futures trades, as the trading pools offer deep liquidity, and the Bid/Ask spread is narrow (usually one or two pips), it is assumed that the best execution control is not as relevant as is the case for securities. But it is nevertheless monitored against various benchmarks, such as open, close high and low, every day.

- For equities, the execution is monitored against a basket of open, close, high and low prices, as appearing on Bloomberg. TCA monitoring is undertaken by the Portfolio Manager when relevant, i.e. when the price action slippage may be significant given the market knowledge of the Portfolio Manager.

- For bonds or other fixed income securities, the control shows that the Portfolio Manager has requested two or three different prices from various sources, and executed the trade at the best price.

