



**H2O**  
Asset Management

**H2O AM LLP**

**Broker and Counterparty Selection**

## COMPANY CONFIDENTIAL

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**Author/s:** Jean-noel Alba  
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## 1. Introduction

H2O AM is an asset manager. H2O AM manages funds and mandates on behalf of a diversified client base.

The nature of the investments, the large volume imposes a large list of brokers and counterparties that should be review periodically.

- Brokers and banks of this list are mainly leaders in their sector of activity.
- Specialized brokers are used mostly in niche markets.

Execution fees when paid by the fund (Futures, Equities) are aligned for all counterparties.

Brokerage paid, given the large volume, is systematically negotiated with our counterparties at the fairest price to benefit the unitholders of our funds.

For the equities & CFD, a decreasing brokerage applies with identical thresholds for all counterparties.

TCA (Transaction Cost Analysis) is periodically undertaken to choose the best vehicle for execution.

Eligible counterparties and brokers must be supervised and regulated.

For OTC transactions subject to ISDA, the banks must be noted.

## 2. Brokers Selection Process for Execution

### 2.1. 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 Counterparty Relationship Manager; this is submitted for approval to the Broker Committee. This Committee comprises the following members:

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

The broker committee is in charge to review and approve the Broker List. The committee meets at least twice a year.

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 eligibility controls.

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 Deputy CEO or delegated to the counterparty's relationships manager.

## **2.2. Legal framework**

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

a) Forex and OTC trades

ISDA agreements must be in place:

- For mandates or dedicated funds, when clients request such arrangements, a Commission Sharing Agreement (CSA) is requested for long-term trades (usually > three month tenure). The ISDA agreement negotiations should start 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.

b) Repos: A Global Master Repurchase Agreement (GMRA or French equivalent when adequate, available & relevant) must be in place.

c) Securities lending: ISDA agreements must be in place (French document when adequate, available & relevant).

d) Futures: Give up agreements must be in place.

- e) Interest rate swaps (IRS): Cleared Derivatives Execution Agreement (CDEA) must be in place.
- f) For any other financial asset class, the corresponding legal documentation must be in place.

### 2.3. Risk and Compliance approval

All Brokers are approved by H2O Risk & Compliance before being integrated into a selection process. In this regard, H2O uses a scoring process for each Broker based on below criteria:

#### a) Compliance Checks

Compliance team will perform due diligence from a KYC/AML perspective and will consider :

- Shareholding structure,
- Identification 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,
- Financial results for last two years,
- Sanctions & embargos lists, including sensitive and banned countries,
- Peps (politically exposed persons),
- Negative news.

In addition, Compliance MIFID diligences will include :

- Best execution policy,
- Conflicts of Interest Policy
- Quality of service: continuity of service, commercial relations, market information.
- Execution: dealing functions, liquidity depth offered, price, costs, speed of execution, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of an order.
- Processing: STP, proportion of failed trades.

#### b) Risk Checks

For ISDA counterparties, Risk team will assess the creditworthiness of brokers and will consider:

- Financial criteria : Tier 1 capital base
- Market data : level of CDS 5 years spread
- External public info : agencies rating

#### c) Scoring escalation process

Total scoring	Level of Approval required	Diligence KYB
< or = 10	Risk and Compliance	Every 3 years
Between 11 and 15	Deputy CEO	Every 3 years
Between 16 and 30	Broker committee	Yearly
> 30	Forbidden	

## **2.4.Operational Framework**

Before inception of a new Broker, the Middle Office Department of H2O makes sure that all SSIs (Standard Settlement Instructions) and BIC Code are available and have been added to the operational platform used..

If the respective Heads of the Middle-Office Operations evaluate that the operational risk associated with the new Broker 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 Funds 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.

## **2.5.Periodicity of Selection**

The list of Brokers is revised a least once a year or when needed if a Compliance breach or an important event is detected (poor quality of service, bad reputation news, sanctions etc...). Either the Portfolio Managers or the H2O Risk can trigger a revision process.

## **2.6.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 or the Deputy CEO and the Counterparties relationships manager, and submitted for information to the Executive Committee. It is also transmitted for information to the monthly Compliance & Risk Monitoring Committee.

## **2.7.Reporting on activity with brokers & top-five execution venues**

The reporting of 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 Counterparties relationships manager to maintain the broker data / transactions database.

In addition, H2O publishes the report on top-five execution venues used for order execution on a yearly basis. The following elements are disclosed:

- a) class of financial instruments;
- b) venue name and identifier;
- c) volume of client orders executed on that execution venue expressed as a percentage of total executed volume;
- d) number of client orders executed on that execution venue expressed as a percentage of total executed orders;

- e) percentage of the executed orders referred to in point (d) that were passive and aggressive orders;
- f) percentage of orders referred to in point (d) that were directed orders;
- g) confirmation of whether it has executed an average of less than one trade per business day in the previous year in that class of financial instruments.

### **2.8. Exception to the Broker list**

Any exception to the Broker list has to be requested by Portfolio Managers from the Risk and Compliance Departments. 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.

### **2.9. Trial list for New Brokers**

New brokers after approval by the Counterparties relationships manager can be added temporarily in a trial list. Trial list is only allowed for cash Bonds DVP, futures, and equities. These trades will face a clearing house for listed derivatives, or a prime broker for OTC trades. New brokers for Forex or OTC trade without ISDA are not permitted in the trial list. At the next broker committee these brokers after an activity analysis will be added into the broker list after validation of the committee.

## Annexe 1 : Broker list Sample

The Broker list validated by the Broker Selection Committee is composed of 2 categories. Each category is sub divided by asset class (Cash Management, Government Bonds, Corporate Bonds, Emerging Bonds, Futures, equities, Forex, Interest Rates Swaps, Repos, OTC volatility)

- A. H2O AM Approved Broker List
- B. Opportunistic counterparties: For opportunistic trades are subject to approval before execution.



Brokers List 2019  
06-v1 Signed.pdf

## Annexe 2 : Broker Scoring criteria

Quality of service (from H2O Policy)	Continuity of service
	Commercial relations
	Market information
AML/ reputation criteria (from regulation)	Country Classification List BPCE
	Monitored by local regulator
	Activity
	Reputation risk
	Products/services concerned
	Presence of PEP
	Shareholding structure transparency
	AML/FT policy available?
Additional criteria	Anti Bribery and Corruption policy available?
	Financial criteria such as Tier 1 capital base
	Market data such as CDS 5 years spread
MIFID Criteria (from Regulation)	External public information such as agencies rating
	Best execution policy available?
	Conflicts of Interest policy available?