

Your approach to seeking best execution can vary, but don't neglect the effort

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One adviser holds an annual meeting to examine best execution. Another occasionally checks in with traders and the portfolio manager. A third employs historic metrics, such as VWAP. Whichever method you choose, use it.

"It is absolutely something that every firm has to do," says **Michelle Kennedy**, president of **Compass Compliance Services** in Greenwood, S.C. Regularly test to be sure you're seeking best execution using a consistent process and document your efforts. "That's all they need to do," she says ([IA Watch](#), Nov. 1, 2010).

Remember, you don't have to achieve best execution but you should seek it. As a [2001 speech](#) by former OCIE Director **Lori Richards** makes clear, this is a legal obligation - stemming from your fiduciary duty to your client. She said advisers are "required to 'periodically and systematically' evaluate the quality of execution services received from the broker-dealers that are used to execute fund trades."

Cost is but one factor to weigh

Price is not the only factor you should consider. Richards also noted elements such as the speed of execution, the certainty of execution and the commission rate or spread.

Granted, best execution isn't likely to float to the top of an examiner's to-do list these days but, as attested to in a recent **SEC document request letter**, you are likely to be asked to produce any "documents created in the evaluation of brokerage arrangements and best execution."

In May, **FINRA** deploys a [new rule](#) that includes some tweaks to its policy on best execution. It includes five factors to consider: 1. the character of the market for the security 2. the size and type of transaction 3. the number of markets checked 4. the accessibility of the quotation and 5. the terms and conditions of the order as communicated to the firm.

[Guidance](#) released by the SEC in 2006 suggests advisers seek "the best qualitative execution for the managed account," and consider factors such as "the value of [soft dollar] research provided as well as execution capability, commission rate, financial responsibility, and responsiveness to the money manager."

Besides these elements, Kennedy recommends clients consider the value of services provided, the implementation costs, liquidity provided, confidentiality of trading intentions, the adequacy of the broker-dealer's capital and any other factors your firm or its best execution committee elects to ponder.

Best practices from your peers

"We meet twice a year," says **Cathy Simmons**, CCO at **Legacy Wealth Management** (\$782M in AUM) in Memphis, of her firm's best execution committee. It reviews "the services we get from the three custodians we use," she says. Members also peruse a spreadsheet with trading cost data by category of security. She times the meeting with her review of the firm's best ex policy, which reads in part that the firm seeks to "ensure that clients receive fair value considering the relevant variables in implementation of our various investment recommendations."

HPM Partners (\$754M in AUM) in New York holds an annual best execution meeting, says CCO **Rob Seco**. Much of the talk surrounds fixed-income securities. Staff look at trade confirms, allocations across accounts, fill rates and times and ask traders if they're happy with the custodians' service.

The small firm of **Daruma Asset Management** (\$1.8B in AUM) in New York, with only 15 employees, doesn't have a best ex committee, says CCO **Veronica Stork**. She periodically

queries traders to assess the worth of their brokers. "The people using the research have to make the value judgment," she says.

Once a year, **Christian Brothers Investment Services** (\$4B in AUM) in Chicago asks its subadvisers to report what they do regarding best execution. This is supplemented by looking at trading data. "We ask for a random, four-week period of trades" from the subadvisers, says CCO **David Skelding**, adding this review looks at pricing, timing and other elements.

A New York CCO reviews execution reports from the firm's lone clearing firm, which has an exclusive contract with the RIA. A CCO in Minneapolis scans data on historical transactions, which also are examined by the firm's traders and CIO. They look for trends.

Test your procedures

Seco's favorite test cross references trading against the firm's gifts and entertainment logs. "That's an easy spot to catch a conflict of interest," he adds. A gift from a broker could cause him to look at the market rate of recent trades with the broker. **Elizabeth Krentzman**, a principal with **Deloitte** in Washington, D.C., advises you be on the lookout for a new broker that suddenly attracts much business and ask why.

A common mistake to avoid is to use average price rather than testing actual trades, points out **Valynda Ewton**, president of **Broker/Dealer Concepts** in Dallas. Krentzman doesn't have a problem with you using average transaction costs and notes many firms do. The important thing is to do some due diligence on "where you're spending your commission dollars ... and does that make sense?" she adds.

Those reviews should match the frequency called for by your policies and procedures, says Kennedy. She also recommends you review your trading blotter and consider adding a broker field. In that column, automate the notation of a transaction involving capital changes or dividend reinvestments. This will make it easier on SEC examiners when they're reviewing your blotter and you when you're looking at broker activity.

Because best ex with fixed income can be so difficult, look at who you're giving this business to and flag any outliers, recommends **Charles Lerner**, owner of **Fiduciary Compliance Associates** in New York. To test your procedures, compare some trades against published data from *Bloomberg* or other sources, eyeing the comparable bids and asks, he says. Average commissions per share charges that exceed \$0.02 per share should draw your scrutiny.

You could always require multiple quotes on fixed income securities before a trade is executed, says Seco. However, expect a mini-revolt from your fixed-income traders, he warns.

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