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BEST EXECUTION: "*Trust but verify*" is still the soundest path for asset owners to ensure complete fiduciary transparency

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As investment advisors and asset owners emerge from the pandemic, the operational landscape continues to morph into a new reality. The traditional Monday through Friday commute to urban-based offices has evolved first into remote operations from home, perfected during the pandemic, and now increasingly to a hybrid Work-from-Home/Return-to-Work schedule balance. This, in many cases, has been accompanied with a steady exodus from metropolitan areas (where most financial institutions are based), to suburban or rural destinations, often out of state.

While technology can be credited for allowing capital market employees a better work-life balance, it's also changed the landscape in how investment advisors are conducting business today and most likely for the foreseeable future. Similarly, most, if not all our asset owner clients' have been conducting Board meetings, manager due diligence, and investment committee meetings remotely throughout the pandemic. On-site visits to their vendors have been replaced by electronic video communication channel discussions, with participants being scattered far and wide. While the digital age allowed for funds to operate seamlessly, (minus perhaps, a few hiccups last March and April), this approach was considered temporary and the continuation of it will be tested as trustees' seek to ensure that fiduciary obligations to their beneficiaries are being met.

Given these dramatic changes and disruptions, it may come as no surprise that some investment advisors have failed to meet all of their fiduciary obligations – as required under the Investment Advisors Act. This past November, two studies came out, which detailed several deficiencies regarding the managers' obligation to achieve and document "Best Execution." Collectively, these studies serve as a useful reminder that asset owners should not simply assume that their investment managers have all taken the necessary steps to ensure they obtained "Best Execution" on the asset owners' trades.

Specifically, as part of its *2021 Regional Compliance Outreach Program*, the SEC's New York Regional Office provided the findings from its annual review and highlighted the most common short fallings observed in how investment advisors managed their obligations under the Investment Advisors Act. With respect to the managers' "Best Execution" obligations, the most common deficiencies included:

1. Not performing best execution reviews;
2. Not considering materially relevant factors during best execution reviews;
3. Not seeking comparisons from other broker-dealers;
4. Not fully disclosing best execution practices;

5. Not disclosing soft-dollar arrangements
6. Not properly administering mixed use allocations; and
7. Inadequate policies and procedures relating to best execution and/or not following best execution policies or procedures.

Also in November, the National Australian Bank, in collaboration with Lumint and the ACI Financial Markets Association (ACI FMA),[1] published their key findings on the practices of managers trading foreign exchange ("FX"). Perhaps the most startling finding was that 39% of investment advisors indicated they did not even track the execution quality of their FX transactions.

Aside from falling short of the operational requirements for demonstrating the attainment of "Best Execution," failure to measure trading efficiency necessarily means those managers are unable to assess whether their costs are reasonable, or if they could be doing better. As noted by Eric Huttman, CEO of MillTechFX, *"many buy-side firms rely of bilateral relationships with an FX broker and [therefore] don't have access to rates from multiple providers … they [therefore] have no visibility of whether they are getting a good deal…. As a result, they struggle to achieve best execution and are significantly overpaying for FX."*[2]

Whether the deficiencies noted in the two studies were a result of the pandemic, the new remote working environment, or perhaps a combination of both, is difficult to say. What is certain is that asset owners have a right to expect that their investment advisors are meeting the operational, compliance and fiduciary reporting required of them, whether they are based in their urban offices or working remotely from home.

This is not to say that the investment advisors cited in the studies were being nefarious. In many instances, managers with limited operational resources are simply prioritizing other matters. However, it should be noted that advisors who cannot show clients they are doing everything they can to maximize returns (through best execution and other means), will most likely face a set of problems that can be far more detrimental than regulatory admonishment.

As fiduciaries and trusted advisors of institutional assets, investment advisors need to implement sound internal protocols that match their new working environments. In this regard, the soundest way for asset owners to ensure they are meeting their obligations to fund beneficiaries during this "new normal" is to, trust but verify. This will help to ensure complete fiduciary transparency.

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[1] ACI Financial Markets Association (ACI FMA) is a leading global trade association representing the interests of the professional wholesale financial markets community. Established in 1955, ACI FMA is focused on enhancing best market practices and supporting market participants to adhere to principles of ethical conduct. It has over 9,000 global members, including 60 national associations.

All members of ACI FMA and of ACI National Associations are required to accept the principles of behaviour and market practice espoused by the FX Global Code and to follow other relevant market-applicable Codes of Conduct endorsed by ACI FMA.

[2] Anita Hawser, Many buy-side firms have no visibility on FX costs, study finds, November 11, 2021

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