

# Learning on the job

Brian Mitchell, head of dealing and portfolio control at Baring Asset Management, is proof that you don't need an Oxford or MIT education to rise through the buy-side ranks. **Victor Anderson** speaks with him about how Barings formalised its execution policy, his Mifid expectations for 2008, and the part Baring's technology plays in providing evidence that the firm's best execution policies have been met

**Can you tell me a bit about Barings?**

Baring Asset Management is a wholly owned subsidiary of Massachusetts Mutual Life Insurance Company. We currently have approximately £26 billion under management spread across institutional funds, mutual funds, private clients and alternative investments. Our London operation was launched in 1955 and we currently have over 100 investment professionals including 14 dealers in two primary locations trading equities, bonds, FX along with derivatives, with offices in Hong Kong, Boston and Tokyo.

**You're responsible for Baring's Mifid initiatives in relation to execution and also for the firm's general regulatory compliance to its new execution policy. How do you see this year panning out from a Mifid perspective?**

On the trading side most buy-side firms will have done close to the bare minimum to get themselves up and running for 1 November. They've all, I'm sure, got their execution policies signed off as well as their various conflict of interest policies etc circulated. I think for people like us most of the execution policies we received from our brokers and venues were only three- or four-page documents with not much detail.

What you'll find during 2008 is that most buy-side firms will be asking for more granularity in terms of how and where brokers are executing on their behalf. For example, we'll

be asking for sample reports of transaction cost analysis (TCA) so that we can see what our brokers can do; we'll be asking whether they have a smart order router (SOR) and how they are using it and what its preferences and latency rates are.

**Is there a requirement from the EU and the FSA under Mifid that is driving buy-side firms to request greater granularity from their brokers and trading venues?**

No, it's not a regulatory requirement. The requirement for us is to analyse who we're dealing with and being able to justify why. I don't see how you can do that by not knowing what their systems can and cannot do. It's like doing a due diligence study and there will need to be more due diligence done on the granularity of execution service providers.

**As Baring's head of dealing, do you see this process of evaluating brokers and trading venues ushered in by Mifid as a positive one? Has it been a worthwhile exercise?**

I think that process started back in the days of CP176, which kicked it all off. I think the end of 'softing' arrangements started that process, and you can see that from the fact that the FSA has retained all the unbundling stuff, which is arguably a bit of gold plating in Mifid terms.

But I think it helped because it started focusing people's minds on how much they are paying for internal and external research, and perhaps more importantly [to an investment manager], how much they are paying for elements of execution.

Having to better justify research and execution costs started back then and I think it has given greater granularity to our clients along with buy-side trading desks as senior

## What is CP176?

Consultation Paper 176 was published by the FSA in April 2003. In the 50-odd page document, the regulator proposed to phase out the then widespread 'softing' and 'bundling' practices in the investment management industry. Softing or soft commissions is the term given to the arrangement whereby a broker agrees to absorb the cost for certain goods and services provided to a fund manager; the fund manager in return agrees to route a certain level of business to the broker. Bundling arrangements involve a broker providing a fund manager with a package of services including trade execution and research for a single price. Often these costs were passed on to the end investor.



management/compliance teams have needed to ensure that they were maintaining appropriate oversight. Generally traders, compliance and legal departments would have created their execution policy, but 2008 will see us all having to monitor our adherence to that policy. This process has added more rigidity to the oversight function of the trading desks. Certainly in the UK, most of the Mifid requirements were being done [prior to the introduction of Mifid], but it was never as formalised.

***That's certainly something BST has heard a lot about – that the processes were already in place, although they weren't necessarily formalised and firmed up into a policy document.***

Exactly, it was a case of good market practice in areas like transaction cost analysis. When CP176 came out, for example, it was just for UK fund managers trading in Europe, but you can't disagree with the principle of keeping processes as visible as possible and understanding your costs. So why not do that globally?

We did, although there was a bit of resistance from Asia where unbundling was a newer concept and isn't strictly necessary, even though it is good practice to my mind. A lot of firms have been doing this sort of thing, although now you have to document it in four or five-page documents and ensure that people in the legal department and retail/institutional clients can understand it.

***What about having to prove that your organisation has adhered to its execution policy?***

Ideally traders will have to have quarterly meetings in order to sign off or be seen to be signing off the fact that they have adhered to their policy. How do you prove that? Well, you had better make sure that at least you've

discussed it in a meeting, reviewed your OMS and TCA data and then written down some relevant comments/conclusions on it, so that at least there is an audit trail.

***That will also be an important consideration when the FSA comes knocking?***

Of course. It's called evidencing. They're expected to start visiting UK firms sometime in Q1 this year I believe; they'll be looking at what firms like ourselves have done in order to comply with Mifid. All our internal meetings have been minuted and documented in order to help comply with these requirements. I'm sure the FSA will not come in and say: "Prove to us that you achieved best execution on this particular trade". That's not likely to happen, but we will have to know/show what we did, what our view of it looked like, and how we monitored our adherence to it [our execution policy].

***I'm sure the FSA will not come in and say: "Prove to us that you achieved best execution on this particular trade"***

***I should imagine that technology plays a significant role in helping Barings in terms of evidencing and its interpretation of best execution?***

Well, be careful – we've all got the same definition now. There are seven or so variables, although if you're a retail investor there are only two – price and cost. For larger institutional investors there are many variables including percentage of daily volumes and speed of execution, for example. Remember, clients are signing up to your execution policy and as long as you're following that policy, you're complying with what you told your clients.

***But surely your technology underpins that whole process, regardless of what tools you may be using? After all, the processes that make up your execution policy must be auditable and repeatable?***

That's right. People use their technology in different ways. There are so many ways of using, for example, these TCA tools that most buy-side organisations use. You have an established process of how you use it and apply it – and of course you have to be able to evidence it.

***Have you seen or felt any changes in terms of demand for greater disclosure or transparency from your clients since the start of November?***

We sent out a range of pre-Mifid information to our clients updating them about what we did and why, including our execution and conflict of interest policies, and there have been a few more questions from clients once they've taken the time to read the documentation. But hopefully they have been reasonably well informed about how we do this as it is.

***What about the FSA? Have you had any Mifid-specific communication from the regulator?***

Not directly into me, (maybe our Mifid project manager or compliance team); I think the FSA has been very proactive in the lead up to Mifid. They were involved in many of the industry meetings leading up to 1 November and providing guidance for buy-side firms and working with the IMA [Investment Management Association]. They will be going around and conducting checks during 2008, but that's only likely to start happening at the end of Q1. We'll obviously have to ensure that we are doing things like our trade reporting and transaction reporting correctly – that sort of stuff.

## Life of Brian

Head of dealing and portfolio control, Baring Asset Management

**How did you get into the industry?** I gradually worked up and through the operations side, then started getting increasingly involved in all aspects of the trading side of the asset management business. I've had stints at Fleming Investment Management, Morgan Grenfell Asset Management and Fuji Bank. I rejoined Flemings in 1994 and then joined Barings in January 1999.

**What did you study?** I've focused throughout my 20+ years on industry courses but augmented this studying by completing the part-time Investment Management Programme at the London Business School a while back.

**Where is home?** Much Hadham in East Hertfordshire (just north of London).

**Not Glasgow, where you were born?** No, I'm probably a southerner now. Time, my wife, and my kids have just about converted me.

**What's on your iPod?** It's eclectic to say the least; Goldfrapp, Snow Patrol, Avril Lavigne – the newest, (I have three young kids!). I also have some old David Bowie, Gary Newman, some Marillion, Dixie Chicks, The Smiths and, of course, Scottish bands like The Proclaimers.

**Any winter breaks planned this year?** Probably not outside of Six Nations rugby trips – I'm not a skier. The winter has come to me this month though – we're having a few extra rooms put in upstairs and with no windows 'Jack Frost' seems to have moved in.



**I hear that you are the main sponsor of Barings' phased OMS upgrade?**

Yes, we're in the process of upgrading our legacy OMS. Our LatentZero [Minerva] platform has supported our equities business for about five years now and we also use their Sentinel product for pre- and post-trade compliance. We're currently using Minerva v4.0 for equities and FX and we're busy with UAT [user acceptance testing] – we're adding fixed income to the platform this quarter as well. Generally buy-side people are revisiting their legacy OMSs in order to decide whether they are good enough for the purposes for which they were originally implemented. Getting back to the Mifid discussion, it has prompted a lot of people to revisit their technology. Is the technology good enough? Can we use it to support other products? Can we automate the systems a bit better?

**With reference to your OMS upgrade, what are your options? Trying to migrate all your business onto the same OMS or are you looking for a replacement?**

We completed our due diligence a while ago. We had a look at what was available at the time and decided that we wanted all our asset classes traded on the same platform and we decided at the time that LatentZero was the best product to support our equities business when we implemented it back in 2001, even

though no system is ever perfect. In an ideal world you want everything on a single platform; you want your order generation, your order management, your compliance checking, and probably your settlement functions supported by the same platform.

**And your execution management functions?**

Well, there's a discussion out there as to whether OMSs can support order management and execution management functions. That depends on who you speak to. OMS people will say that execution is just an extension of the service they already provide, although there is an argument that OMSs only manage the order while EMSs are responsible for finding the venue.

The obligation under Mifid is that you must look for all the liquidity pools and make sure you're hooked up to the most appropriate ones. Who is going to do that most expediently for you, and cheapest? Do you think your OMS provider will be able to do that with their hundred clients or will a separate EMS platform like FlexTrade or Bloomberg TradeBook with its focus on execution be able to do it better? There is a third option – going to the sell side to an organisation like Goldman Sachs and use their REDIPlus platform for example. That, to my mind, is a reasonably big call you've either made or may need to make in 2008.

**This discussion is moving into the realm of smart order routing, which in my understanding, is just another term or system for accessing multiple liquidity pools which is what EMSs are doing anyway? Isn't SOR a sneaky way for brokers to attract buy-side order volumes to increase their commissions?**

Yes, most of the larger brokers like UBS or Instinet for example, are already offering smart order routing services. Basically, the big firms are spending IT money developing ever better systems and effectively raising the barriers to entry and yes, it's just another service that needs to be taken into consideration when selecting your brokers. It's not that different from picking up the phone and speaking to the trader and him evaluating the market makers or liquidity pools available. SOR is primarily just an internal STP method of managing that process. What they're getting increasingly good at is taking buy-side orders (which increasingly travel via FIX), breaking them up into thousands of smaller orders and firing them down via various algorithms (assuming you're not already doing this yourself).

It's definitely more visible and talked about and is being pushed by Mifid best execution obligations and market fragmentation. It's also increasingly part of the sell-side 'marketing' armoury and some brokers are using SOR as a way of attracting more volume, as you'd expect. >