OCIE Publishes Risk Alert Regarding Best Execution Compliance Issues

On July 11, 2018, the Office of Compliance Inspections and Examinations ("OCIE") published a National Exam Program Risk Alert (the "Risk Alert") on the most frequent compliance issues relating to best execution by investment advisers identified in deficiency letters from OCIE examinations of investment advisers.[1] The Risk Alert reflects issues identified in deficiency letters from over 1,500 adviser examinations. The most frequent deficiencies identified by OCIE staff are summarized below.

1. *Not Performing Best Execution Reviews*

   OCIE staff observed advisers that did not conduct a best execution evaluation when selecting a broker-dealer to execute transactions, or were unable to demonstrate to OCIE staff (through documentation or otherwise) that they performed such an evaluation.

2. *Not Considering Materially Relevant Factors During Best Execution Reviews*

   OCIE staff observed advisers that, in connection with their best execution evaluations, did not evaluate any qualitative factors relating to a broker-dealer (such as the broker-dealer's execution capability, financial responsibility, and responsiveness) and did not solicit input from the adviser's traders or portfolio managers about the broker-dealer.

3. *Not Seeking Comparisons from other Broker-Dealers*

   OCIE staff observed advisers that used certain broker-dealers without considering the quality and costs of services available from other broker-dealers. The staff also observed advisers that used a single broker-dealer based solely on cursory reviews of the broker-dealer's policies and prices, or on that broker-dealer's summary of its services, without seeking comparisons from other broker-dealers.

4. *Not Fully Disclosing Best Execution Practices*

   OCIE staff observed advisers that did not adequately disclose their best execution practices, including that certain types of client accounts may trade the same securities after other client accounts, and the potential impact of this practice on execution prices. The staff also observed

[1] National Exam Program Risk Alert, Compliance Issues Related to Best Execution by Investment Advisers (July 11, 2018), *available at* https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20IA%20Best%20Execution.pdf.

Copyright © 2018 Fried, Frank, Harris, Shriver & Jacobson LLP
A Delaware Limited Liability Partnership

that certain advisers disclosed in Form ADV that they reviewed trades to ensure that execution prices fell within an acceptable range, but in practice did not do so.

5. *Not Fully Disclosing Soft Dollar Arrangements*

   OCIE staff observed advisers that did not appear to fully and fairly disclose in Form ADV the use of soft dollar arrangements or the allocation of the cost of such arrangements among clients. In addition, the staff observed advisers that did not adequately disclose products and services acquired with soft dollars that did not qualify for the Section 28(e) safe harbor.

6. *Not Properly Administering Mixed Use Allocations*

   OCIE staff observed advisers that did not appear to reasonably allocate the cost of a mixed use product or service according to its use and did not document the rationale for mixed use allocations.

7. *Inadequate Policies and Procedures Relating to Best Execution*

   OCIE staff observed advisers that did not have any policies relating to best execution, that failed to monitor broker-dealer execution performance, and that had best execution policies that did not take into account the current business of (including the types of securities traded by) the adviser.

8. *Not Following Best Execution Policies and Procedures*

   OCIE staff observed advisers that did not follow their own best execution policies, including with respect to seeking price and other comparisons from competing broker-dealers, the allocation of soft dollar expenses, and the ongoing monitoring of execution price, research, and the responsiveness of their broker-dealers.

The lack of documentation regarding an adviser's best execution practices and improper or inaccurate disclosure regarding such practices are highlighted throughout the Risk Alert. The Risk Alert encourages advisers to reflect upon their own practices, policies and procedures in these areas and to implement improvements to their compliance programs. As with other OCIE risk alerts, this Risk Alert could serve to signal the industry that the SEC is unlikely to be lenient in future enforcement cases regarding best execution practices, and all investment advisers should review their current practices to ensure compliance with their stated policies, procedures, and disclosures to clients.

* * *

Authors:

Jessica Forbes

Stacey Song

Joanna D. Rosenberg

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

Contacts:

London		
Gregg Beechey	+44.20.7972.9172	gregg.beechey@friedfrank.com
David Christmas	+44.20.7972.9222	david.christmas@friedfrank.com
Kate Downey	+44.20.7972.6221	kate.downey@friedfrank.com
Mark Mifsud	+44.20.7972.9155	mark.mifsud@friedfrank.com
David W. Selden	+ 44.20.7972.6201	david.selden@friedfrank.com
New York		
Jonathan S. Adler	+1.212.859.8662	jonathan.adler@friedfrank.com
Lawrence N. Barshay	+1.212.859.8551	lawrence.barshay@friedfrank.com
Jeremy R. Berry	+1.212.859.8796	jeremy.berry@friedfrank.com
Gerald H. Brown, Jr.	+1.212.859.8825	gerald.brown@friedfrank.com
Jessica Forbes	+1.212.859.8558	jessica.forbes@friedfrank.com
Darren A. Littlejohn	+1.212.859.8933	darren.littlejohn@friedfrank.com
Robert M. McLaughlin	+1.212.859.8963	robert.mclaughlin@friedfrank.com
Todd J. McMullan	+1.212.859.8190	todd.mcmullan@friedfrank.com
David S. Mitchell	+1.212.859.8292	david.mitchell@friedfrank.com
Kenneth I. Rosh	+1.212.859.8535	kenneth.rosh@friedfrank.com
Lisa M. Schneider	+1.212.859.8784	lisa.schneider@friedfrank.com
Stacey Song	+1.212.859.8898	stacey.song@friedfrank.com
Washington, D.C.		
Richard I. Ansbacher	+1.202.639.7065	richard.ansbacher@friedfrank.com
William J. Breslin	+1.202.639.7051	william.breslin@friedfrank.com
Walid Khuri	+1.202.639.7013	walid.khuri@friedfrank.com
Bradford R. Lucas	+1.202.639.7483	brad.lucas@friedfrank.com
Andrew P. Varney	+1.202.639.7032	andrew.varney@friedfrank.com
Rebecca N. Zelenka	+1.202.639.7260	rebecca.zelenka@friedfrank.com